

# City of San Diego Water Utility

## Report on the Engineering and Financial Feasibility Study - Revenue Bond Series 2009

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*Final*

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# Executive Summary

CDM has prepared this Engineering and Financial Feasibility report at the request of the City of San Diego Water Department in connection with the proposed issuance of approximately \$400.4 million of Revenue Bonds, Series 2009 A and B. The total amount of bonds issued may increase should refunding of a portion or all of the outstanding 1998 Revenue Bonds be economically feasible. For purposes of this report such refunding has not been included.

## Study Methodology

- The City of San Diego Water Department provided extensive documentation related to Department budget, operations, capital planning, water supply planning, and staffing. In addition, CDM conducted interviews with Department operations, engineering and management staff to review operation and capital planning processes.
- Physical inspections of a sample of above ground reservoirs, pump stations, treatment plants and facilities were conducted to review physical condition and operating practices.
- CDM has examined the financial operations of the Department through reviews of financial reports, operating and capital budgets, financial models, and other statistical and financial information, and through discussions with the Department's financial staff. We have performed independent financial tests and analyses necessary to support our findings and opinions.
- The results of our investigations and analyses are presented in this report, with separate sections describing principal assumptions, organization, regulatory issues, water system infrastructure, operations and maintenance, planned capital improvements, water system financing, and the additional bonds coverage test.

## Organization

- The City of San Diego Water Department operates under the authority of the City and its elected mayor and City Council. The Water Department Service Area includes the City of San Diego and other wholesale customers (California-American Water Company, City of Del Mar, Santa Fe Irrigation District, San Dieguito Water District).
- Key management personnel have the necessary qualifications and experience to effectively manage the operations of the Water Department and assure timely implementation of the Capital Improvement Program ("CIP").
- The Water Department is operated under an enterprise fund, which meets the budgetary, auditing, cost accounting and other financial needs of the Water

Department. All connection fee proceeds are restricted to growth-related project expenditures and maintained in a separate account.

## Water System Infrastructure

- The Water Department is responsible for the construction, operation and maintenance of water treatment plants, reservoirs, pump stations and pipelines within its service area. These facilities include 3 treatment plants, 9 raw water reservoirs, 32 treated water reservoirs, 49 pumping stations, and 3,460 miles of pipeline.
- The City has not been able to access the public municipal bond market for several years, but the Water Department capital program has continued. The planning and design efforts have progressed so that projects would be ready to go to bid and construction when bond funds became available. Moreover, essential project construction has not been postponed, as funding on a cash "pay-go" basis, and short-term notes, have been used for project construction costs.
- The Water Department's capital planning process includes "big picture" strategic planning that considers the impacts of regulations, growth, and rehabilitation and replacement in the development and prioritization of projects for the capital program. While projects related to regulatory requirements have the highest priority, projects for rehabilitation and replacement of aged infrastructure are also included. Work to prepare an updated master plan for water facilities will begin by the end of 2008.
- Field inspections of a representative sampling of the City's facilities were conducted in July 2008, utilizing a ranking system of 1 to 3.
- The City has been working closely with the California Department of Public Health (CDPH) for a number of years to bring the water utility system into compliance with current CDPH requirements, and is in a position to evaluate and address potential impacts that may arise with future regulations. The current CIP list gives high priority to projects that address regulatory compliance issues.

## Water System Financing

- The Water Department CIP has been developed using a capital project prioritization process that has been adopted by the City Council. This policy establishes an objective process for ranking CIP projects to have a basis for choosing the most compelling projects for implementation. The following prioritization factors are listed in order of importance:
  - Health and Safety Effects
  - Regulatory or Mandated Requirements

- Implications of Deferring the Project
  - Annual Recurring Cost or Increased Longevity of the Capital Asset
  - Community Investment
  - Ease of Implementation
  - Project Cost and Grant Funding Opportunity
  - Project Readiness
- The proposed CIP for the study period of FY 09 through FY 13 totals some \$724 million, including over \$207 million for treatment plant projects, \$280 million for pipeline projects and \$237 million for other projects.
  - The Department plans to fund 80 percent of project expenditures with bond funds, with the remainder funded from net operating revenues on a pay-as-you-go basis.
  - Currently, the 273,000 customer accounts serve approximately 1.3 million residents, along with businesses and institutions. Population growth is projected at about 1 percent per year while water demands are less due to increasing water conservation practices.
  - An estimated 15 percent voluntary reduction in water demand has been projected for FY 09 and FY 10 in response to a Stage 1 Voluntary Compliance Water Watch declared in July 2008 by the City due to the shortages in regional and imported water supplies.
  - Water Department revenues are derived principally from water service charges and impact fees on new connections. In February 2007, the City adopted a series of 6.5 percent rate increases to be implemented annually through 2011. In addition, in November, the City Council will be requested to approve a rate increase to recover revenue in the amount of the increased water wholesale purchase costs from the County Water Authority which will become effective in January 2009. Furthermore, the City Council will be requested to approve a temporary rate increase to support the Indirect Potable Reuse Pilot Project (IPR).
  - The Water Department maintains a financial planning model (rate case) that identifies rate and fee adjustments required for the long-term sustainable funding of operations and the capital program while maintaining financial reserve fund target levels and complying with all bond covenants.
  - The cash flow analysis of projected revenue and revenue requirements presented in Table 4-9 of the report shows that projected revenues, including approved service charges and bond proceeds, will be sufficient to adequately and sustainably operate

and maintain the Water System, maintain or exceed all targeted reserve levels, pay existing and proposed debt service, comply with existing bond covenants, and provide cash from net operating revenues for CIP project expenditures.

- As demonstrated in Table 4-10, the Water Department expects to remain in full compliance with its bond covenants for existing and projected debt service coverage over the projection period. Based on the enacted water rates to be effective in FY 09, FY 10 and FY 11, the annual debt service coverage for all senior debt will exceed 284 percent. Moreover, aggregate debt service coverage on existing bonds, after the refinancing of \$207 million in private placement notes, will exceed 157 percent.

## Opinions

- Based on the engineering and financial studies performed related to the System, we believe that the Water Department's organizational structure, planned CIP, and financing plans are sound for purposes of ensuring reliable service and for repaying the bonded debt service on all existing and proposed bonds during the projection period.
- Correspondence with the California Department of Public Health (CDPH) was compared to the proposed CIP listing to confirm that outstanding compliance issues which would be remediated by capital construction were included within planned projects. Project progress is within the compliance schedule set by CDPH. No other compliance or regulatory issues were identified during the term of this study.
- Estimates of project costs for the planning period are reasonable and include allowances for contingencies and inflation. Moreover, it is our opinion that the projects can be completed as scheduled. While the City's centralized Engineering and Capital Project Department has a limited one-year history of completing projects, they have the personnel, policies and practices in place that indicate the ability to manage and implement the proposed five-year CIP. Many of the Department staff have a history of work with the Water Department and the new Department has the ability to access additional staffing resources when needed as the CIP expenditures increase.
- It is our opinion that the Water Department's practice of cash financing at least 20 percent of total CIP expenditures represents a reasonable balance between cash and debt financing of capital improvement needs for the System. Moreover, our evaluation of sources and uses of funds suggests that additional annual net revenues will be available after FY 09 for cash financed "pay-go" projects in excess of 20 percent of the total CIP.
- The above-ground physical facilities inspected are generally well maintained, modern and in good condition. The projections of operating results presented in



our report are based on reasonable projections of future revenue and expenses, and conservative growth estimates. Unanticipated changes in conditions, such as a worsening or long-term continuation of the existing water shortages, would only slightly reduce the annual net revenues, as the reduction in water service revenues would be significantly offset by reductions in the Water Department's cost of water purchases. The Department may, however, need to further adjust the level of revenues, reserves and/or expenses if significant changes in conditions occur.

- Based on the financial projections and analyses presented in this report, it is our opinion that the Water Department will be able to adequately finance the five-year CIP, meet all cash requirements of the Water System, and comply with all debt service coverage requirements during the study period.

These summary statements do not address all of the issues examined and described in the full report. Accordingly, the findings and conclusions presented herein should not be considered complete except in the context of the detailed descriptions and information contained in the report.

# Section 1

## Introduction

The City of San Diego Water Department (the "Water Department") provides water treatment and distribution services to over 1.3 million people through over 273,000 service connections. Its service area covers 403 square miles, of which 342 square miles are within the City boundaries. The water sold by the Department is a combination of imported supplies purchased from the San Diego County Water Authority ("CWA") and local water supplied by City-owned surface water. The City's water treatment and delivery system ("Water System") comprises three City-owned water treatment facilities and a water delivery system that includes 9 raw water reservoirs, 32 treated water reservoirs, 49 pump stations and over 3,460 miles of water lines. In addition to retail service to residences and businesses within the City, the Water Department supplies water to wholesale customers, including: California-American Water Company, City of Del Mar, Santa Fe Irrigation District and San Dieguito Water District. The Water Department also distributes recycled water for landscape irrigation to a number of customers including City and federal offices and parks, California Department of Transportation (CALTRANS), U.S. Navy, University of California at San Diego (UCSD), and private businesses.

From 2003 to 2008, the City was unable to access the public bond market. However, during that time the Water Department continued to plan, design and construct capital projects using cash and private placement note issuances for financing. During the 2003-2008 period, 86 projects were completed at a capital expenditure of over \$595 million.

To continue to operate, maintain and expand the City water facilities while remaining in compliance with state and federal health and safety regulations, the Water Department has identified a capital program that will be 80 percent financed with long-term bonds. Additional funds for the program will come from net operating revenues (primarily service charges). Also, existing short-term notes that funded essential projects in 2007 and 2008 will be refinanced with the proposed bond proceeds.

Throughout this study, references to a particular fiscal year always use the end date. For example, Fiscal Year 2007-2008 (July 1, 2007 through June 30, 2008) is described as FY 08.

### 1.1 Background

The City of San Diego incorporated in 1850 and purchased the local water company in 1901 to begin municipal water service. The City operates under a "strong mayor" form of government, and as a department of the City's Public Utilities Group, the Water Department ultimately reports to the elected mayor and the eight-member City Council, who are elected by district.

In 1944, the City and other local water purveyors formed the CWA with the express purpose of gaining access to imported water supplies as a member agency of the Metropolitan Water District of Southern California ("MWD"). In 1947, the first MWD water was delivered to the San Diego area. Of the 35 member CWA Board of Directors, the City holds 10 voting positions.

## 1.2 Purpose

The purpose of this study is to investigate the principal facets of the Water System that may impact the security of the proposed bond issue, and to provide an independent engineering, institutional, operational and financial analysis of the proposed bond's feasibility for review by bond issuing agents and potential investors. This report assesses the condition of the Water System, need for scheduled capital improvements, and the financial feasibility of the Capital Improvement Program ("CIP").

## 1.3 Scope

This report provides a summary of the engineering evaluation of existing and planned facilities and a five-year (FY 09 - FY13) financial analysis for determining the financial strength of the Water Department and its capability of meeting debt service requirements on existing and proposed bonds.

The scope includes review of key issues relating to water supply and regulatory impacts, the existing facility planning reports, field inspections of certain key water facilities, review of water demand projections used for facility planning, review of environmental and permitting regulations, and review and evaluation of the existing CIP.

Evaluation of the financial feasibility of the proposed CIP is based upon a review of historical financial information provided by the Water Department, an examination of the Water Department's revenue and expenditure projections, and the preparation of cash flow analyses examining the sources and uses of funds relating to the projected system operating and capital expenditures through FY 13. The projected level of debt service coverage for the proposed FY 09 and future revenue bond issues are determined and compared with the requirements of the bond coverage tests.

## 1.4 CDM Qualifications

CDM has prepared this engineer's statement of bond feasibility. CDM is one of the country's largest engineering firms specializing in water, wastewater, and solid waste, with nearly 4,000 staff located in more than 85 offices throughout the United States. CDM has offices along the entire west coast and is familiar with the unique environments in which our clients operate.

CDM has extensive experience in water and wastewater utility planning, financing, design, and operations analysis. Our clients range from very small communities to large municipalities. CDM, and in particular the project staff for this study, have extensive experience throughout California and a history of working with the City. CDM has prepared more than 50 engineer's statement of bond feasibility reports over the past decade to assist 35 separate entities issue nearly \$7.5 billion in bonds. This experience can provide stakeholders with the confidence that a thorough and effective analysis demonstrates that the Water Department is stable, well-managed, and capable of successful project execution and sustainable utility operations.

## 1.5 Organization

As discussed earlier, the City has been in the business of providing water services to its citizens for over 100 years. During this time, the City has grown from a population of approximately 650 persons in 1850, to 350,000 in 1950, and approximately 1.3 million in 2007. The Public Utilities Group oversees the operations of the Water and Metropolitan Wastewater Departments. In the City's 2009 budget document, the Water Department had a budget of over \$533 million and a staff of 778 persons. The Water Department is divided into 4 divisions as illustrated in Figure 1-1.

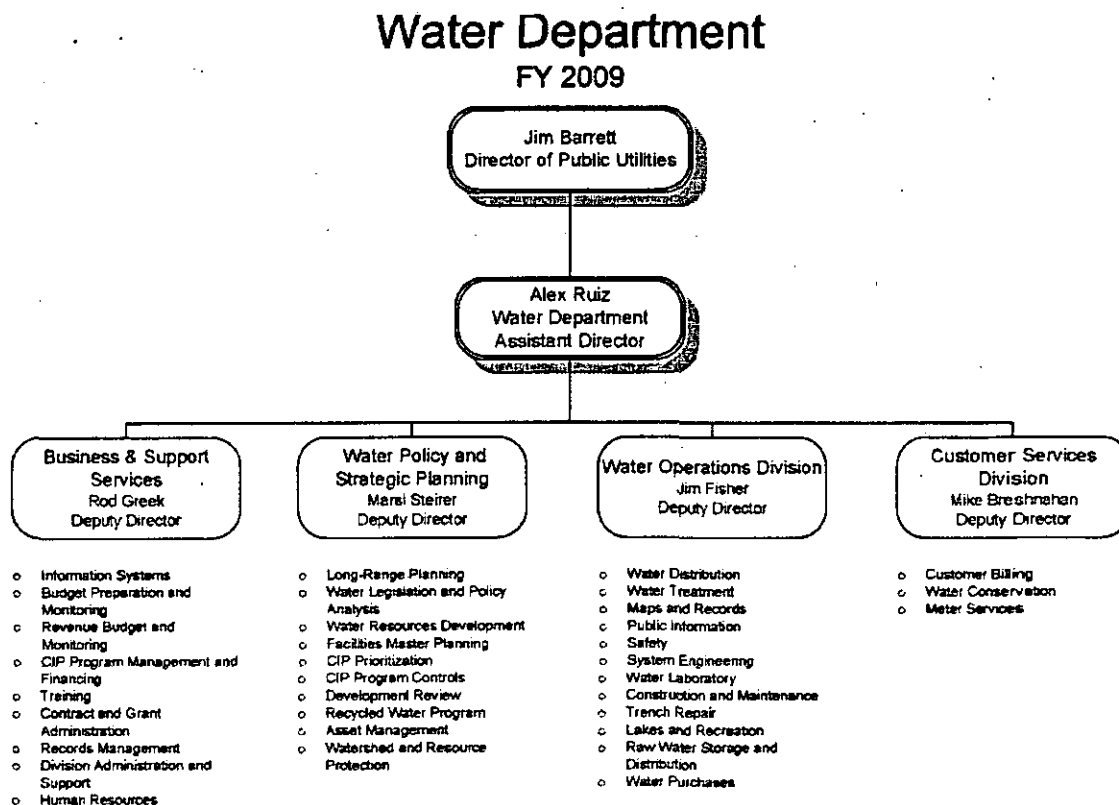


Figure 1-1  
Water Department Organization Chart

The Director of Public Utilities and Water Department Assistant Director and the four divisions and their current managers are:

- Director of Public Utilities - Jim Barrett
- Assistant Director - Water - Alex Ruiz
- Business and Support Services - Deputy Director - Rod Greek
- Customer Services Division - Deputy Director - Mike Breshnahan
- Water Operations Division - Deputy Director - Jim Fisher
- Water Policy and Strategic Planning - Deputy Director - Marsi Steirer

In addition to these four divisions, the City has a centralized Engineering and Capital Projects Department that provides the Water Department with a full range of engineering and construction services. Further discussion of the institutional design and operation of the Water Department and other services provided by the City is discussed in Section 3.

## Section 2

# Assumptions

In the preparation of the forecast of future operations summarized in this report, we have made certain assumptions with respect to conditions, events, and circumstances that may occur in the future. While we believe such assumptions are reasonable and attainable for the purpose of forecasting the Water Department's future operations, the actual results may differ materially from the forecast. The principal assumptions used in the forecast of future operations are as follows:

- In preparation of this report, we have relied on historical, financial, and statistical data supplied by Water Department staff. While such data is considered reliable, we have not independently verified the accuracy of such data.
- The Water Department's estimates of content, scheduling, and cost of the five-year CIP present a projection of the future construction program. Water Department staff is continually updating the CIP, which may result in changes in the project costs and schedule after the publish date of this report. These changes typically are related to updated prioritization of projects that does not materially affect the financial feasibility of the proposed bonds.
- Debt service schedules for existing bonds were provided by Water Department staff. The principal repayments on 2007 and 2008 private placement notes issued for Water Department project expenditures will be funded from the proposed Series 2009 Bonds. The projected debt service for the proposed Series 2009 Bonds has been provided by Water Department staff. As the Series 2009 Bond proceeds will fund projects through FY 2010, this analysis also includes additional Water Department bonds anticipated in the five-year period ending in FY 13. The financing terms for these additional bonds were provided by Water Department staff. The series 2009 Bonds and all additional bonds were assumed to be senior debt.
- An estimated four percent (4 percent) annual inflationary escalation has been used for CIP projects based on the Engineering News Record Construction Cost Index most recent 10-year annual average. Operating expenses generally inflate at 4 percent per year (based upon the Consumer Price Index), except for electricity and other utilities, which are forecasted to inflate at 8 percent per year. After 2009, escalations in the projected unit water supply purchase costs are not included. These increases, when implemented by CWA, are evaluated and customarily passed through to the City's water customers following Proposition 218 notice and upon approval by the City Council and Mayor. Approximately 40 percent of the average customer water bill is for water supply costs, but projections of the unit water purchase rates do not materially affect any findings in this analysis.
- The Water Department operating projections include the expense of improved and expanded Water Department facilities that come on-line during the projection

period. The Water Department receives both raw and treated water supplies from CWA. The proportion of these two supplies delivered to the different districts in the City is based on long-term planning criteria to minimize the citywide long-term costs of water services.

- There are no expected material changes in federal and state laws or regulations that would adversely impact the Water Department's ability to secure tax-exempt financing for the capital program, place more stringent limitations on water quality, materially increase the cost of constructing or operating the Water System, or otherwise adversely impact operations of the Water System. The general economy that impacts Water System costs and user's capabilities to pay water service charges is expected to remain relatively stable, in spite of the slowing of the Southern California economy and home sales markets.
- In July 2008, the City declared a Stage 1 Voluntary Compliance Water Watch, and called for voluntary reductions in non-essential water demands. The Water Department, as reflected in this analysis, has projected a 15 percent reduction in typical customer demands and in the need for water supply purchases for the projected years FY 09 and FY 10. Demands are assumed to return to normal by FY 2011.
- Rate adjustments this November to pass through additional CWA water costs and to fund the IPR pilot project will be approved and have been included in the analyses.
- All revenue and revenue requirement projections presented in this report are expressed on a cash basis identifying the sources and uses of funds, consistent with the Water Department's operating budgets and general industry standards for municipally owned and operated water utilities.

## Section 3

# Water System

The purpose of this section is to describe and discuss the City's water system. These descriptions include discussion of the Department's organizational structure, water supply, regulatory issues, current system facilities, utility operations and maintenance practices, and the capital improvement plan to rehabilitate, replace and expand the water system infrastructure.

### 3.1 Background

The City has approximately 273,000 retail connections serving 1.3 million residents, businesses and institutions. Citywide water facilities include three water treatment plants, 9 raw water reservoirs, 32 treated water reservoirs, and 49 pumping stations. The water system is managed and operated by the Water Department within the City's Public Utilities Group.

In 2007, the City Council adopted a series of four 6.5 percent water rate adjustments. This revenue stream will support both the operation and CIP expenditures through the projection period of this analysis. The FY2009 budget increased funding for deferred maintenance and capital projects, and funding of the City's general fund, workers' compensation, and public liability reserve funds. In addition, the City has recently issued Comprehensive Annual Financial Reports providing unqualified external audit opinions for fiscal years 2003, 2004, 2005, 2006, and 2007. These actions have increased financial stability of the City at large and the Water Department, and set the stage for renewed use of water revenue bond financing.

Over the last five years, the City has purchased an average of 90 percent of its water from the San Diego County Water Authority ("CWA"), with the remainder from local surface and groundwater sources and the use of recycled water for irrigation. The City projects that with increases in the sale of recycled water and consistent use of local surface water, City purchases of CWA water could drop to around 85% of its water supply. Approximately 90 percent of CWA supplies are currently imported from the Metropolitan Water District of Southern California ("MWD"), a value that is projected to drop significantly over the next decade. In 2007, 230,000 acre-feet of water was delivered to customers citywide. A 7 percent increase in this demand is anticipated between 2007 and 2020, driven primarily by a projected 14 percent increase in the City's population.

As a component of this study, we have reviewed the organizational structure and institutional relationships of the Water Department. This review focuses primarily on the ability of the Water Department to plan and implement capital projects.



## **3.2 Organizational Structure/Institutional Analysis**

The Water Department and the Metropolitan Wastewater Department make up the San Diego Public Utilities Group. The Water Department is divided up into four divisions, which generally fall into the planning, operations and business functions needed for management of the utility. The organization chart in Section 3 on page 1-3 provides a summary list of the program responsibilities of each division. Each of these divisions shares a role in the implementation of the Water Department's capital program including service levels and facility maintenance requirements, regulatory compliance, project definition and prioritization, preliminary design, budgeting and financial management. In addition to the services provided within the Water Department, the City has recently centralized the provision of engineering services for capital projects. The Engineering and Capital Project Department works with the Water Department to take capital projects from the preliminary design phase to full design, bidding and construction. Services provided by this department are formalized through a service level agreement and coordinated regularly with Water Department staff.

## **3.3 Water Policy and Strategic Planning**

The Water Policy and Strategic Planning Division leads the strategic and capital project planning efforts to provide for both water supply and the facilities needed to distribute water to customers. City water supply planning includes consideration of local supply development and management, and active involvement in issues related to the imported water supply. The Water Department is responsible for facilities planning through the preliminary design phase. Facilities planning includes evaluation of regulatory requirements, growth impacts and system condition.

### **3.3.1 Water Supply Planning**

The City's current water supply portfolio includes water purchased from CWA, recycled water produced by the City, and local surface water. The City purchases treated and untreated water from CWA. The City is one of 24 cities and water agencies who make up the membership of the CWA. The City population is 43 percent of the total within the CWA service area, and the City has 10 of the 35 directors on the CWA Board.

Over the last five years (2003-2007), the City has purchased an average of more than 90 percent of its water from the CWA with the other supplies from City-controlled local sources. These include surface water, recycled water and groundwater. Successful efforts to increase local sources could reduce future CWA deliveries to the City to approximately 85 percent within the next five years.

Since 1990, approximately 85 to 90 percent of CWA's water supplies have been from MWD, which imports water from the Bay-Delta area in Northern California and from the Colorado River. In response to the Western region drought conditions, reductions in surplus water available from the Colorado River, and pumping restrictions from

the Bay-Delta, MWD has recently instituted reductions in delivery of agricultural water linked to those who purchased water under a voluntary interruptible supply and delivery of water for groundwater recharge projects. These recent reductions have had a minimal impact on the City but depending on the resolution of the environmental issues in the Bay-Delta and the drought-related water shortages, further delivery reductions may occur. Currently the City is in a Stage 1 Voluntary Compliance Water Watch, and voluntary reduction in non-essential demand is projected to reduce water consumption by 15 percent below normal levels in 2009 and 2010.

In recent years, in an effort to diversify water supply sources and reduce reliance on water from MWD, the City and CWA have both worked to expand water supply options. CWA has developed a water transfer agreement with the Imperial Irrigation District and a canal lining project that have resulted in the delivery of 55,000 acre-feet ("AF") in 2007 to the CWA supply structure. By the year 2020, these two programs are expected to provide 267,000 AF per year. These new supplies are expected to reduce the reliance on MWD water by at least half. Other programs that will enhance the development of additional local water supplies include groundwater, recycled water, surface water, and conservation projects. Some projects will be developed by CWA, while others will be managed by other agencies with partial financial support from CWA.

The City has completed a number of planning efforts to identify potential projects that would increase the available water supply under the direct control of the City. These planning efforts include:

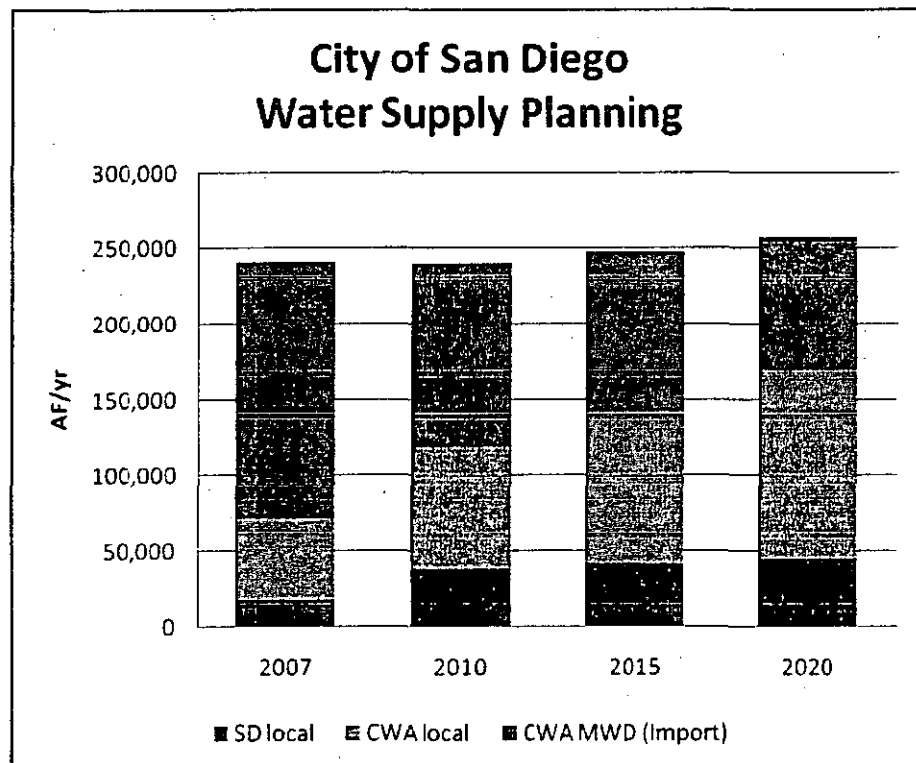
- 1997 Strategic Plan for Water Supply
- 2002 Long Range Water Resources Plan
- 2004 Strategic Business Plan
- 2005 Urban Water Management Plan
- 2007 Reclaimed Water Master Plan
- Drought Ordinance
- Water Facilities Master Plan (beginning Fall 2008 for the post FY2013 CIP)

The Urban Water Management Plan is developed and updated on a five-year cycle in accordance with the requirements of the State's Urban Water Management Planning Act. The City has prepared plans in 1985, 1990, 1995, 2000, and 2005. The plan demonstrates water reliability for the coming 25-year period. The plan is prepared in conjunction with information from MWD and CWA, the primary water wholesalers

for the City. It considers population factors, demand projections, emergency planning and response requirements, water quality, water recycling, and drought planning.

Along with the development of water management strategies, these planning efforts have resulted in identification of a number of potential projects that could enhance the City's water supply portfolio. These projects include investigation of groundwater recharge/ storage projects, brackish water desalination projects, recycled water production and distribution projects, and enhanced conservation programs. In November 2007, the City Council approved the San Pasqual Ground Water Management Plan, under which the City will identify the viability of groundwater basin conjunctive use and storage, with state and federal funding support.

Figure 3-1 below is based upon supply planning data from both the CWA and the City, illustrating how planned programs and projects will reduce the City's reliance on imported water from MWD. The figure represents all water usage including potable and recycled, as well as water losses. Based upon reports from the Water Department and from CWA, Water Department reliance on MWD imported water is projected to reduce from the current levels of about 90 percent to less than 40 percent, provided that planned local CWA and Water Department projects are implemented.



**Definitions:**  
 SD Local – surface water, recycled water and groundwater  
 CWA Local – IID water transfers, canal lining transfers,  
 CWA MWD (Import) – Water sold to CWA by MWD (includes water from Bay-Delta and Colorado River)

**Figure 3-1  
City of San Diego Water Supply Planning**

### **3.3.2 Water Conservation**

In addition to the conservation-oriented inclining block water rate structure in use for residential customers, the City and the CWA have active water conservation programs. These programs provide customer education and financial incentives for the installation of water saving devices such as low flow toilets, water efficient clothes washers and weather-based sprinkler controllers for irrigating large landscapes, parks and green belts. Many of these programs provide permanent long-term benefits. In fact, water usage within the City is approximately the same today as it was in 1992, despite a 21% increase in population.

In response to recent water supply shortages announced by MWD and CWA, the City has recently declared a Stage 1 Voluntary Compliance Water Watch that asks citizens to voluntarily reduce water use. Programs such as the "Twenty-gallon Challenge" provide information to the public on ways residential water use can be reduced to help the area manage current and potential future additional reductions in the delivery of imported water. The City is currently updating a drought ordinance that outlines voluntary and mandatory actions that would be taken should further water supply restrictions occur.

### **3.3.3 Recycled Water**

The Water Department distributes recycled water from two City reclamation plants (operated by Metropolitan Wastewater Department), and currently serves approximately 400 retail and 3 wholesale customers. Approximately 8,000 AF of recycled water was delivered in FY 07. A recycled water master plan was completed in 2007 that is the basis for recycled water distribution projects that are included in the CIP.

### **3.3.4 Facilities Planning**

The Department's capital project planning has been based upon a combination of improvements based upon regulatory requirements and system requirements as defined in various strategic planning efforts. The Department has initiated efforts to begin an update to its Water Facilities Master Plan in the fall of 2008 that will outline the capital program and projects that will be needed during the FY10 through FY30 planning period.

### **3.3.5 Capital Project Execution**

#### **Capital Project Planning and Preliminary Design**

The Water Department is responsible for capital project planning, prioritization, financing, program financial management and preliminary design. Section 3.6 discusses the project prioritization process and details the current capital program projects. Following the completion of preliminary design, project implementation is transferred to the City Engineering and Capital Projects Department. Services are provided via an annual service agreement, with all costs being paid from Water Department budgets.

### Capital Project Design, Bid and Construction

The mayor's office has instituted an organizational review process referred to as Business Process Reengineering ("BPR"), which has been used to improve efficiencies, reduce the cost of City government and to enhance the services offered to City residents. In July 2006, a study related to the provision of engineering services to City departments (including the water and wastewater utilities) was initiated to assess and implement a revised organizational structure that would consolidate these services under a single operational unit. This study was completed in April 2007; implementation of the organizational change began during the FY08 budget planning.

The new Engineering and Capital Projects Department ("E&CP") has been structured to be an effective, streamlined, and centralized service department. It manages a varying workload by adjusting to the ebb and flow of capital project demands among all City departments with less disruption than had previously occurred within individual departments. In addition, the E&CP is designed along the following key *recommendations of the BPR*:

- Consolidate all CIP design and construction functions so that projects are delivered in accordance with annual execution plans
- Implement a uniform and objective ranking system to prioritize all CIP projects
- Improve coordination of projects within the right of way
- Enhance the City's asset management systems
- Operate E&CP as a matrix organization
- Enhance communications and coordinate by placing all staff within one location

In recognition of some of the unique needs of the utilities, the Water and Wastewater departments have retained responsibility for CIP development and project planning, program management, project financing, budget control and compliance with the rate case plan and revenue program. In addition, O&M engineering responsibilities have remained within the Water and Wastewater departments. As a result of this consolidation of the City engineering operations, 25 positions were transferred from the Water Department to the E&CP department, which has a total of 527 positions. Of that number, approximately 140 positions are identified as assigned to the water and wastewater service sections. In addition, the department provides environmental and permitting services for the City's capital program. Services that require a specific expertise, such as treatment plant and large diameter pipeline design, utilize outside contractors who will be managed by this department.

Each year the E&CP and Water Department develop a formal Service Level Agreement that defines the roles and responsibilities of each party, and establishes schedules and timelines for project implementation, communication protocols,

performance measures and dispute resolution. As the E&CP was created recently, the performance of its service relationship with the Water Department has not yet been reviewed. However, given the number of defined water project positions, and E&CP's capability to shift work responsibilities within the large pool of engineers and construction specialists, the department has the ability to efficiently perform its prescribed services to the Water Department.

### 3.4 Regulatory Issues

#### 3.4.1 Current Regulatory Issues

The City's water treatment and delivery system falls under federal, state, county, and municipal regulations. The general types of regulations which may be applied to capital project implementation and other department operations include those listed in Table 3-1.

Table 3-1 General Statutes, Laws, and Regulations Guiding the Water Department	
Locality	Statute, Law, or Regulation
Federal	Energy Policy Act Clean Air Act Endangered Species Act National Environmental Policy Act National Historic Preservation Act Federal Insecticide, Fungicide, Rodenticide Act National Fire Protection Act1 Uniform Fire Code Toxic Substances Control Act Uniform Building Code Clean Water Act
State	California Prop 65 Emergency Planning Community Right to Know Act Hazardous Materials / Wastes Pesticides Pollution Prevention Above and Underground Fuel Storage Integrated Waste Management Act Safe Drinking Water Act State Drinking Water Standard Hydrostatic and Potable Water Discharge Permit Storm Water Code Compliance CARB Title 13 California Environmental Quality Act
County	Clean Air Act – local enforcement Recreational Use Permits in Domestic Supply Reservoirs

Table 3-1 (cont.) General Statutes, Laws, and Regulations Guiding the Water Department	
Locality	Statute, Law, or Regulation
Municipality	City of San Diego General Plan & Progress Guide City of San Diego Historical Resources Register Coastal Zone Development Permit Environmental Quality Ordinance Site Development Permit Hazardous Material Disclosure Noise Control Watershed Protection Energy Conservation Medical Waste Recycling of Construction Debris Storm Water Code Compliance

The Operations Division maintains a detailed inventory of regulations and requirements that relate to all aspects of the water utility operations. This data provides information on statutes, regulating agency, areas of impact (air, water, hazardous materials, release impacts, etc.), the functional areas that the regulation may effect, and the implementation documentation within the department. This information is used to monitor reporting or permitting activities as they are required during facility planning and operation. Compliance with regulations related to capital project design and construction is monitored by both Water Department and E&CP staff.

Other than the Department's ongoing work with the CDPH, no other outstanding regulatory issues were identified during this review.

The US EPA and State of California adopted new rulings related to surface water treatment and water quality in the late 1980's. In response to these regulatory requirements and to provide water quality management for the City water supplies, the Water Department initiated a Drinking Water Quality Improvement Program in the late 1980's. This program and its related studies led to the development of various capital projects at the water treatment facilities to optimize operations and to provide ozonation as a primary disinfectant system.

Since 1994, the Department has been working closely with the CDPH to ensure that the water treatment and distribution systems achieve compliance with CDPH requirements. Table 3-2 lists outstanding CDPH compliance order issues and the projects the Department is pursuing to address those issues. We have opined on whether or not the projects use proven and reliable technology and would adequately address the CDPH's issues.

The proposed CIP includes 20 projects that are planned to respond to regulatory concerns or requirements. These projects have a total cost of approximately \$480 million over the five year capital planning period.

### **3.4.2 Potential Future Regulatory Issues**

In the future there may be additional regulatory requirements related to other emerging contaminants, such as pharmaceuticals, and their potential impact on drinking water quality. The treatment processes being implemented at the City treatment facilities have the potential to provide effective treatment for many of these issues. Therefore, based upon the City's established working relationship with CDPH, the implementation of treatment plant improvements and the established regulatory monitoring program in the operations division, it appears that the City has practices in place that can properly respond to potential future regulatory issues.



**Table 3-2**  
**CDPH Compliance Related Projects**

Compliance Order Issue	Project Name	Work Description	Proven & Adequate?	Compliance Status
Rancho Bernardo CCR: reservoir rehabilitation. Start by July 31, 2007 and complete by December 31, 2008	Rancho Bernardo Reservoir Upgrade	The project calls for the rehabilitation of the 10-million gallon, trapezoidal-shaped concrete reservoir. Work will include improvements of the beam connection, repairs of the roof slab and columns and a seismic retrofitting to bring the reservoir up to code compliance mandate by Water Department and State Department of Health Service standards.	Yes	Under Construction
Optimize Treatment of all WTP: effluent turbidity goal of 0.1 NTU	Upgrade projects at Alvarado, Miramar and Otay WTPs	See project specific descriptions.	Yes	See project descriptions
Water main replacement: award contracts annually for construction of at least 10 miles per year	AA Water Main Replacements	Annual allocation for the replacement of water mains throughout the City. The existing cast-iron system is either approaching or has exceeded its expected life of 40 years. As of 2008, breaks are occurring at the rate of approximately 100 annually.	Yes	On-going program in place, approximately \$40 million planned each year in CIP
Rancho Penasquitos Pump Station (formerly called Rancho Bernardo). Begin construction by Jan 31, 2008 and complete construction by Jan 31, 2010.	Rancho Penasquitos Pump Station	Project calls for the design and construction of a new pump station and a new Del Mar pressure reducing station near the site of the existing stations. The new station will house 5 new vertical pumps each rated at 6000gpm and an additional pump can for future expansion. The Del Mar pressure reducing station will be replaced with a new facility.	Yes	Under Construction FY2009-FYy2010
Miramar WTP Contract B (construction of three flocculation and sedimentation basis, demolition of flocculation and sedimentation base no. 3 and rehabilitation of the operations building). Start construction by Mar 31, 2008 and complete by Mar 31, 2010.	Miramar WTP Contract B - Floc/Sed Basin	This project will expand the plant capacity from 140 mgd to 215 mgd to meet water demands through 2030. The construction scope of work will involve: Construction of 4 new Flocculation and Sedimentation basins 5, 6, 7 and 8 inclusive of associated piping - Demolition of the twelve existing filters - Demolition of the existing backwash water tank and associated piping - Demolition of the existing Flocculation and Sedimentation basins - Construction of 60 inch influent pipelines to New Flocculation Basins - Construction of 108 inch & 120 inch settled water pipelines	Yes	Under Construction FY2009-FY2010

000410

CDM

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3-10

**Table 3-2**  
**CDPH Compliance Related Projects**

Compliance Order Issue	Project Name	Work Description	Proven & Adequate?	Compliance Status
Miramar WTP Contract C (Ozone equipment). Start construction by June 30, 2008 and end construction by Mar 31, 2010.	Miramar WTP Contract C - Ozone Equip/Install	This project consists of installation of Ozone equipment and Liquid Oxygen delivery and storage facilities. Three Ozone generators will be provided to generate ozone for supply and distribution of ozonated feed gas to two pre-ozone and three settled water ozone contactors. Once this project is completed, ozone will replace chlorine as the primary disinfectant.	Yes	Under Construction FY2008- FY2010
Alvarado WTP Flocculation and Sedimentation Basins I & II - rehabilitation. Start construction by Dec 31, 2010 and complete by June 30, 2012.	Alvarado WTP Ph 3 Rehab Floc/Sed Basins	This project consists of rehabilitation of Flocculation/Sedimentation Basins 1 & 2, as well as installation of Ozone pipeline from Ozone Building through the exiting basins to the existing filter.	Yes	In-Design Construction to begin FY2011
Otay 2nd Pipeline I-15 to 54th street. Start construction by Mar 31, 2008 and complete by Mar 31, 2010.	Otay 2nd Pipeline - Cast Iron Replacement Phase	This project includes the installation of approximately 1.3 miles of new 42-inch welded steel pipe in 54th Street between El Cajon Blvd and Chollas Station Road which will provide a means to bypass 3.5 miles of the 36-inch cast iron pipeline, located west of 54th Street, abandonment of 1200 feet of existing 36-inch cast iron pipe. This segment includes flow meters, pressure control valves, and connections to the Trojan, Otay I and II and Mid City Pipelines. Also, this project consists of replacement of approximately 3000 feet of existing cast iron pipe in 54th Street with new 16-inch PVC distribution pipelines that will maintain the City's reliable source of potable water.	Yes	Under Construction FY2009- FY2010
Alvarado WTP Ozone equipment. Start construction by Jun 30, 2008 and complete by Dec 31, 2010.	Avarado WTP Ph 4 Ozone	Construction of ozone disinfection and pumping facilities to meet new Federal Safe Drinking Water requirements and State of California Department of Health Services compliance order, and the associated process changes to make ozone the primary water disinfectant and chlorine secondary.	Yes	Under Construction FY2009- FY2011
Otay WTP Phases I and II (construction of new flocculation and sedimentation basins, make improvements to filtration facilities, and install chlorine dioxide facilities). Start by Sept 30, 2008 and complete by Dec 31, 2010.	Otay WTP Upgrade Phase 1	The Otay WTP Upgrades Phase 1 project will construct a new flocculation and sedimentation basin and make improvements to the sixteen existing filters. The filters improvements include granular activated carbon (GAC) filtration media and providing a pumped backwash system, a filter to waste system, replacing the filter under drains and increasing the media depth.	Yes	Under Construction FY2009- FY2011

000411

CDM

October 3, 2008

3-11

**Table 3-2**  
**CDPH Compliance Related Projects**

Compliance Order Issue	Project Name	Work Description	Proven & Adequate?	Compliance Status
	Otay WTP Upgrade Phase 2	The Phase 2 upgrades to the Otay WTP include construction of a chlorine dioxide shaft contactor, ClO2 generation system, sodium chlorite tank, ferrous chloride (FeCl2) tanks and feed system, powder activated carbon (PAC) facilities, reservoir circulator units, yard piping, electrical support facilities, instrumentation and controls systems, and associated site work.	Yes	Under Construction FY2009- FY2011

000412

CDM

October 3, 2008

3-12

### 3.5 Current Water System Facilities

The City's service area covers over 400 square miles, which includes 342 square miles in the City, and serves approximately 1.3 million customers. To assess the current condition of the water system, we performed a site evaluation of several of its key facilities. The site evaluations involved walking through the sites and visually observing the physical condition of several water treatment plants, water pump stations, and reservoirs.

The City owns and operates three main water treatment plants, 9 raw water reservoirs, 32 treated water reservoirs, and 49 pumping stations. Our inspections were limited to sites best representing the overall condition of the City's facilities, and a summary of the City's facilities is provided below. A rating system of 1 to 3 was applied to each facility visited. In conclusion, the overall ratings (detailed below) were: Treatment Plants -- 3.0; Pump Stations -- 2.5; and Reservoirs/Standpipes -- 2.0.

#### 3.5.1 Rating System Definition

A grading system was used to evaluate the water facilities. This approach and methodology result in standardized definitions of condition regardless of the facility type (treatment plant, pump station or reservoir).

During the assessment we established a condition grade for each of the sites inspected. The grading system for the facilities is as follows:

##### **Good Rating -- 3**

A rating of 3 implied the facility was in operation, in good working order, with all or most of the equipment associated with the facility in good mechanical condition. A 3 rating was given if all maintenance was being performed in accordance with manufacturer's recommendations, and that backup equipment, where provided, was in good condition and ready for operation as required.

##### **Fair Rating -- 2**

A rating of 2 implied the facility/equipment was in operation and in fair mechanical condition. A rating of 2 was given if the equipment was nearing the end of its useful life, and in need of repair or replacement.

##### **Poor/Out of Operation Rating -- 1**

A rating of 1 implied the facility/equipment was in poor condition and/or out of service altogether.

#### 3.5.2 Water Treatment Facilities

The City has three main water treatment plants: Alvarado, Miramar and Otay. Table 3-3 summarizes the capacity and demands of these treatment facilities. In general all three treatment facilities are in good working order.

Table 3-3 Capacity and Demand of the City's Water Treatment Plants						
Water Treatment Plant	Original Design Capacity (mgd)	Current Rated Capacity (mgd)	Future Rated Capacity (mgd) (1)	Current Average Demand (mgd)	Current Peak/Max Demand (mgd)	Condition Rating
Alvarado	66	150	200	89.5	116.8	3-Good
Miramar	100	140	215	88.1	135.3	3-Good
Otay	40	34.2	40	20.7	30.5	3-Good
<b>Total</b>	<b>206</b>	<b>324.2</b>	<b>455</b>	<b>198.3</b>	<b>282.6</b>	
1)Source: Water Department						

### Alvarado Water Treatment Plant

The Alvarado Water Treatment Plant (WTP) began operation in January 1951 with a capacity 66 mgd. It is located adjacent to Lake Murray near the City's border with La Mesa. Plant capacity is 150 mgd and will be increased to 200 mgd by completion of the Upgrade /Expansion Project.

*The Alvarado WTP is rated at 3. The plant is currently under construction to include additional treatment tanks and ozonation.*

While some of the facility is older, including the flocculation tanks and filter control consoles (upgraded, but still housed in the original cabinets), overall the facility is very clean and well maintained. A total of five maintenance staff is responsible for maintaining the facility, with I&C and HVAC maintenance performed by others. This is a relatively small maintenance crew, so staffing may be inadequate for such a large facility. Once the construction project is completed, it is recommended that a staffing study be conducted to determine if additional maintenance staff is warranted. Based on discussion with plant operators, there seems to be adequate operations staff.

A computerized maintenance management system ("CMMS") is being implemented at Alvarado, but work orders continue to be manually generated. Maintenance staff perform daily walkthroughs of the facility, with a daily meeting held in the morning to review the previous day's operation's log. While this seems to be effective, as the facility expands, CMMS should be fully implemented. Currently, estimation of equipment run time is based on calendar days. In contrast, elapsed time meters are more effective tools for accurate scheduling of preventative maintenance.

In summary, the Alvarado WTP is in very good condition, is maintained well, and is rated at 3.

### Miramar Water Treatment Plant

The Miramar WTP began operation in 1962. The WTP is located in the Scripps Miramar Ranch community adjacent to Miramar Reservoir, and provides drinking

water to an estimated 500,000 customers. The WTP's current capacity is 140 mgd and will be increased to 215 mgd by completion of the Miramar Upgrade and Expansion Project.

The WTP is staffed with four maintenance staff plus a supervisor. The facility is currently under construction to expand its capabilities to provide ozonation disinfection treatment. The majority of the old facilities have been demolished and replaced. New facilities include a new administration building, filters and flocculation/sedimentation basins. The completion of the current construction contract will have replaced everything except the distribution pump station and clear wells. The facility is well maintained and in good working condition and has been in continuous operation throughout the construction period. Construction on the current expansion-upgrade project will be complete in 2011.

CDM staff is on site at the Miramar WTP providing design services during construction. Based on our first-hand knowledge of the plant condition and operations, the condition of the facility is rated at 3.

#### **Otay Water Treatment Plant**

The Otay WTP supplies one of the City's three major water service areas, providing up to 34 mgd of potable water to customers primarily in the southern reaches of the City. The plant receives raw water from the Morena, Barrett and Lower Otay Reservoirs.

This facility is well-maintained and operated, but shows some wear with certain areas in need of painting. It is rated at 40 mgd, but regulated to 32.4 mgd. It has 16 existing filters, with construction underway to add an additional settling basin and to convert from chlorine to chlorine dioxide disinfection. Other capital improvement projects are scheduled to replace valves in the filter gallery and replace the ferric chloride tanks.

A total of four maintenance staff plus a supervisor are responsible for maintaining the Otay WTP, which seems to be adequate. Similar to the Alvarado WTP, the maintenance staff does not fully utilize the CMMS program. According to discussions with the Maintenance Supervisor, most of the equipment maintenance is performed on a repair basis. Five operators are assigned to the Otay facility, working on rotating shifts. This seems to be an adequate number of operations staff for the plant.

The Otay WTP condition is rated at 3.

### **3.5.3 Water Storage Facilities**

The City's Water System includes 9 raw water reservoirs with a total capacity of 415,936 AF and 32 treated water reservoirs/standpipes, with 29 currently in operation. Three treated water reservoirs/standpipes were visited, and 2 additional standpipes were discussed with City staff to assess the condition of the reservoirs.

We did not have the opportunity to assess the level of staffing for the reservoir or hydraulics crews. According to City staff, there are two crews of 2 to 3 people, each responsible for checking and maintain the reservoir and standpipes. There is a four-person hydraulics crew responsible for checking and maintaining the pressure reducing stations and the altitude valves. Table 3-4 summarizes the capacity and condition of these storage facilities.

Table 3-4 Water Storage Facilities Inspected		
Facility Name	Capacity MG	Rating
College Ranch Standpipe	1.5	3-Good
La Jolla Country Club Reservoir	0.5	2-Fair
San Carlos Reservoir	5.0	1-Poor (out of service)
Paradise Mesa Standpipe	2.53	3-Good
Redwood Village Standpipe	2.0	2-Fair

#### College Ranch Standpipe

The College Ranch Standpipe is rated at 3. The standpipe is currently in service, and in good operating condition.

The standpipe altitude valve is in good condition. The cathodic protection is also well maintained and in good working order. The standpipe has been drained and cleaned according to the City's inspection schedule. During routine inspection, the tank liners are inspected and coated as necessary. Due to low demand in this area, some operational problems occur due to stagnant water in the standpipe. Chlorine is routinely fed to the standpipe to mitigate this problem.

#### La Jolla Country Club Reservoir

The La Jolla Country Club Reservoir is rated at 2. The reservoir is old and the roof and liner need replacing. The overall condition of the reservoir is fair. Water quality issues require the reservoir to be chlorinated.

#### San Carlos Reservoir

The San Carlos Reservoir is rated at 1, as it is leaking and out of service. The reservoir was emptied, cleaned, and inspected for leakage. Upon refilling the reservoir, it was discovered to still be leaking, and has not been placed back into service. During the visit, evidence of leaking was apparent, and a bee infestation exists at the base of the reservoir. A project to repair this reservoir is included within the current CIP.

#### Paradise Mesa and Redwood Village Standpipes

We did not visit the Paradise Mesa Standpipe or the Redwood Village Standpipe, but discussed the condition of them with a City representative. According to the City representative, the Paradise Mesa Standpipe is in service, and in good working order. The altitude valve and cathodic protection are in good condition. Therefore, the

Paradise Mesa Standpipe is rated at 3. The City representative indicated that the Redwood Village Standpipe has some operational problems related to elevation grade variability in the zone which can cause pressure fluctuations. This facility requires some additional monitoring and managing by maintenance staff and is therefore rated at 2.

### 3.5.4 Pump Stations

Forty-nine pump stations deliver water throughout the City's system. The pump stations are divided into four pressure zone areas, where each area is assigned pump station crews to check the stations on a regular basis. As a general statement, some of the 49 pump stations are located at grade, and vandalism has been a recurring problem. To provide continuous operation during power outages, 20 pump stations have permanent emergency generators and an additional 15 mobile/portable generators are available for use at other pump stations, as needed.

We did not have the opportunity to assess the level of staffing for the pump station crews. According to Water Department staff, each pressure zone has two crews of four people that are responsible for checking and maintaining the pump stations. We visited four stations in one pressure zone area. According to the City, these stations fairly represented all pump stations within the four zones. Table 3-5 summarizes the capacity and condition of these pump station facilities.

Table 3-5 Water System Pump Stations		
Facility Name	Max Capacity MGD	Rating
Climax Pump Station	6.5	2-Fair
College Ranch Hydro Pneumatic Pump Station	2.5	2.5-Fair Plus
Waring Road Pump Station	29.0	3-Good
Eagle Ridge Pump Station	3.4	3-Good

#### Climax Pump Station

The Climax Pump Station is rated at 2. The pump station is located in a residential area, and equipped with four VFD-driven pumps. The VFDs are older and "showing some wear." The piping is also leaking some water. The station itself is fairly cramped, and equipment access is difficult. The facility does not have an emergency standby generator. The station is located below grade, and there are no vandalism or security issues.

#### College Ranch Hydro Pneumatic Pump Station

The College Ranch Hydro Pneumatic Pump Station is rated at 2.5. Although not a typical water pump station, it is considered part of the 49 pump station network. One pump pressurizes a hydro pneumatic tank at the College Ranch Standpipe. The facility does not have an emergency standby generator. The below grade station is



maintained adequately and is physically located within the fenced area of the College Ranch Standpipe. This station has one pump. Typical of all the pump stations visited, intrusion alarms are provided on the access doors and hatchways.

#### **Waring Road Pump Station**

The Waring Road Pump Station is rated at 3. The station is four years old and is in new condition. Five 200 horsepower vertical turbine pumps are manually operated remotely by the Alvarado WTP operators through the SCADA system. Due to low demand in the area, the pumps are operated intermittently, based on pressure. A trailer-mounted emergency standby generator is located onsite. Construction is currently underway to permanently tie in the generator to the pump station for automatic switchover operation. This station has been well maintained.

#### **Eagle Ridge Pump Station**

The Eagle Ridge Pump Station is rated at 3. The site is equipped with two hydrants; one for hooking up to the suction side of the reservoir, and one for the discharge side, providing redundancy to the system. The pump station is equipped with a total of four pumps; two large and two small pumps. The facility does not have an emergency standby generator. The pump station site is well-maintained.

### **3.6 Operations and Maintenance Activities**

A review of budget and planning documents as well as interview information was used to prepare this evaluation of the Water Department operations and maintenance programs.

#### **3.6.1 Staffing and Operations Plan**

The Water Department Operations Division operates and maintains the Water System. This Division is currently authorized to have 460 positions. The division is divided into six major groupings to operate, manage and maintain the system facilities. A review of current operations and the planned CIP does not indicate that a significant increase in positions will be needed as projects are completed. The workforce is divided into the following units and sub-units:

- Public Information
- Administrative Support
- Safety, Security and Emergency Response Program
- Water Operations and Engineering
  - Production Engineering
  - Facility Information Management
  - Distribution System Operations/Optimization

- Optimization
- Distribution Operations
- Distribution Engineering
- Corrosion Engineering
- Water Production
  - Treatment Plants
  - Water Quality Laboratory
- Water Construction and Maintenance
  - North Council Districts 1,5,6,7
  - South Council Districts 2,3,4,8
  - Emergency Services
- Lakes and Recreation/ Reservoir Management

The Operations Division has ISO 14001 certification (International Organization for Standardization), which is a program that establishes a standard for performance that is designed to function on a plan, do, check, act systems approach. All members of the organization participate in the development and operation of this interactive system with the following goals:

- Cost Savings
- Reduced risk to the environment and the employee
- Increased operational efficiency
- Positive external relations and public image
- Improved communications

In addition, the Operations Division operates under a "Bid to Goal" program that establishes performance standards for employees that are set and reviewed monthly and annually for performance/pay reviews.

### **3.6.2 Maintenance Program**

Interviews with the Operations Division maintenance program staff were performed to review the maintenance methodology and practices in use. Key areas reviewed

were employee training and supervision, work order systems and documentation, and work planning and execution.

### **Training**

The division has established a structured training program for all new employees. This program, the Water Academy, provides three weeks of training related to all the City systems and safety programs. In addition, the City provides ongoing classes that lead to water system operator certifications and the City training program is certified to grant continuing education credits. Programs are provided by both internal and external trainers, depending on the particular topic and skills needed. Training programs cover topics such as legal requirements, break repair practices, equipment operation, customer service issues, and ongoing safety practices. Staff members who pursue additional certifications receive compensation recognizing the level achieved even if it is beyond their position requirements. Generally, the department supervisory staff is promoted from within and supervisors take an active role in provision of regular training sessions.

### **Work Order Management**

The operations maintenance staff is divided into teams assigned to specific zones within the City and at the major treatment facility sites. Maintenance work hours are linked to work orders on an average of about 90% of the time. Work orders are linked to a specific asset and are managed by the supervisor of each zone/facility team. Work orders are issued to work crews on a weekly or biweekly basis, depending on the supervisor. Emergency work orders are issued on a daily basis as they occur. According to operations staff, most work orders are related to planned maintenance and about 75% are completed within four weeks from the date requested.

The system is a combination of electronic and manually managed documents, with the work orders generated electronically, the documentation completed manually by field workers and then input by data processing operators on a daily basis. Consideration has been given to a fully automated system, but concerns related to equipment requirements, field conditions and worker computer skills has led to a preference for this hybrid system. There is no automated link between the time reporting and work orders, and the individual supervisors are responsible for auditing time and materials costs for work orders on an informal basis. Analysis of work order maintenance data is not regularly used to establish a predictive maintenance program.

### **Maintenance Planning**

The water distribution system utilizes system redundancy to provide service reliability and emergency response. The system is mapped using GIS and the department engineering staff provides support for the implementation of maintenance/repair projects. Operations management reported that the system currently experiences about 100 breaks per year over the 3,420 miles of pipeline. The

Department's continuing cast iron main replacement program will help to prevent breaks related to aging and deteriorated pipeline sections.

### **3.7 Capital Improvement Program**

The general objectives of the Water Department's CIP are to provide the facilities necessary to meet federal and state requirements, maintain the integrity of the system, and provided satisfactory service and performance to customers at a reasonable cost. To accomplish these objectives, the Water Department must have sufficient operating revenues and adequate funding for CIP projects.

The Water Department reviews the CIP on an ongoing basis to prioritize and plan for program implementation. In addition to projects that are driven by regulatory issues, several planning documents and studies have been developed to define potable and non-potable water demands, alternative supply options, and the infrastructure requirements related to these issues. These plans and studies have identified a number of potential projects for further evaluation at the master planning level. Additionally, the City has operational and short- to mid-term reliability projects compiled in "project summary sheets" as part of the CIP. Master Plans to determine long-term facility needs have been developed independently for the Miramar and Alvarado Service Areas. The City has established five-year periods for the development and integration of the information needed to establish a comprehensive, practical, and functional Master Plan, in part by utilizing the facility plans described above. The City is developing a long-range CIP with an outlook that will extend past the 2013 planning horizon.

The City has recently developed prioritization policies for CIP projects. In May 2008, the City Council approved a policy to establish an objective process for ranking CIP projects to have a basis for choosing the most compelling projects for implementation. The following prioritization factors are listed in order of importance:

1. Health and Safety Effects
2. Regulatory or Mandated Requirements
3. Implication of Deferring the Project
4. Annual Recurring Cost or Increased Longevity of the Capital Asset
5. Community Investment
6. Ease of Implementation
7. Project Cost and Grant Funding Opportunity
8. Project Readiness

### 3.7.1 Master Planned Facilities

Appendix A, Table A-1 presents the list of projects in the proposed CIP as of September 2008. The projects are scheduled for design and construction between FY09 and FY13; the table identifies the justification for each project and estimated then-current cost by fiscal year, using an inflation allowance of 4 percent. Some of the multi-year projects have already incurred considerable costs in the years before FY09, and other projects include construction expenditures after FY13. Table A-2 provides descriptions of each project.

### 3.7.2 Capital Program Implementation

An accurate construction cost estimate is essential to successful project management, fiscal budgeting, and project implementation. The Engineering and Capital Projects Department's Standard Operating Procedure (SOP) provides general guidelines for the preparation of reliable project construction cost estimates. The SOP is included in Appendix B. The development of the construction cost estimates begins with the Water Department at a planning level (10 percent design stage). The Engineering Department further refines the cost estimate at 30, 75, 90 and 100 percent design stages. Cost estimates are also updated if a project is delayed for more than 6 months, or if there are significant changes in the design. The City typically hires outside consultants for large projects. The City's cost estimating guidelines are provided to the consultant, but the consultant is ultimately responsible for their own methods.

The following are the general guidelines for preparation of construction cost estimates as stated in the SOP:

- Preparation of the Engineer's Estimate and associated construction costs
- Types of construction cost estimates
- Construction cost estimating approaches
- Available cost estimating resources
- Ranges of construction administration and contingency costs
- Cost estimate submittals and expected accuracies at various stages of design
- The roles and responsibilities of the participants in the cost estimating process

Table 3-6 lists the elements of a project's costs as identified by the SOP. The range in percentage values listed reflects the varying complexities of a project as well as the varying site conditions that may be encountered.

Table 3-6 Elements of Project Costs		
Project Phase and Components	Range of Project Cost Share	
A – Project Design Costs	20% to 40%	Of Total Budget*
1 – Administration		
2 – Engineering		
B – Project Construction Costs	60% to 80%	Of Total Budget*
1 – Engineer's Est (Const Contract)	30% to 60%	Of Total Budget*
a – Bid Item Quantities		
b – Mobilization	5% to 10% (1)	Of Construction
c – Traffic Control	5% to 10% (2,3)	Of Construction
d – Water Pollution Control	2% to 5% (1)	Of Construction
e – Bonds	2.5% (4)	Of Construction
f – Field Orders	2.5% to 10% (3)	Of Construction
2 – Contingencies	10% to 15%	Of Construction
3 – Const Admin – Field Engineering	10% to 15%	Of Construction
*Total Project Budget (costs) = (Design Costs) + (Construction Costs)		
(1) Depending on location		
(2) Depending on ADT		
(3) Depending on project complexity		
(4) Per specification		
Source: City of San Diego Standard Operating Procedure, CIP Construction Cost Estimates, Table 1		

The cost estimate at the 10 percent design stage is considered a conceptual level rough estimate. The cost estimate at the 30 percent design stage is based on quantities and unit process models further refined by investigation or revised assumptions from the design criteria, site layout, soils reports and completed design drawings. The cost estimate at the 75 percent design stage includes unit prices associated with environmental review, mitigation requirements, and discretionary permits. The cost estimate at the 90 percent design stage is updated with the most recent bidding unit prices. The cost estimate at the 100 percent design stage serves as the final project cost plan.

The following is the expected accuracy of the actual cost of construction for each design stage:

- 30 percent design stage: +30 to -15 percent
- 75 percent design stage: +20 to -10 percent
- 90 percent design stage: +10 to -10 percent

The City's approach for estimating project construction costs is consistent with industry standards and professional practices. Based on our review, we find the cost estimates presented in the CIP and the proposed schedule for completion of the projects to be reasonable.

## Section 4

# Water System Financing

The purpose of this section is to evaluate the financial feasibility of the proposed Water Department revenue bonds to support the funding of the City's proposed CIP of \$724 million through FY 13. This evaluation is based on proforma sources and uses of funds cashflows for the Water Department Fund and evaluation of debt service coverage ratios. The analysis was made to confirm that the utility has sufficient net operating revenues to adequately fund the capital program and projected debt service with appropriate financial safety margins. The funding plan uses the proceeds of the 2009 Series A and B Bonds, and proposed additional bond sales over a projected five years.

### 4.1 Capital Improvement Program

The Water Department has a capital improvement program (CIP) that identifies the construction schedule and estimated costs of projects prioritized for completion. The Water Department reviews and updates its CIP annually. A detailed water system analysis is conducted periodically to identify and reprioritize needed capital improvements. The project costs and other details are modified annually to reflect current needs, priorities and costs. The Department Strategic Plan includes capital projects to remediate existing deficiencies and provide additional capacity in the City's water facilities. A long-term CIP evaluation that extends project definitions through 2020 is currently being prepared.

Table 4-1 presents a summary of the projected five-year CIP for FY 09 through FY 13, as provided by Water Department staff. The annual CIP varies between \$113 and \$178 million per year, with future costs based on a nominal inflationary escalation of 4 percent, to then-current dollars. For a detailed list of projects, see Table A-1 in Appendix A.

**Table 4-1**  
**Proposed Major Capital Improvement Program (Inflated)**

Line No	Project Numbers (a)	Description	Fiscal Year Ending June 30					Total
			2009	2010	2011	2012	2013	
1	1 - 12	Water Treatment Plants	\$86,756,020	\$83,881,204	\$31,310,409	\$1,639,389	\$3,905,061	\$207,492,083
2	13 - 37	Pipelines	\$57,705,209	\$48,074,621	\$53,410,139	\$61,430,309	\$59,022,991	\$279,643,269
3	38 - 45	Pump Station	\$9,550,000	\$3,840,792	\$831,375	\$2,438,729	\$3,523,976	\$20,184,872
4	46 - 61	Storage Facility	\$6,794,422	\$942,589	\$1,522,669	\$4,208,908	\$10,983,215	\$24,451,803
5	62 - 69	Reclaimed Pipelines	\$3,104,606	\$7,106,101	\$7,414,401	\$2,980,224	\$1,000,000	\$21,605,332
6	70 - 74	Groundwater	\$2,019,816	\$7,643,634	\$18,528,908	\$20,127,520	\$1,209,935	\$49,529,813
7	75 - 77	Security	\$3,796,050	\$10,109,000	\$7,592,776	\$326,295	\$0	\$21,824,121
8	78 - 87	Miscellaneous	\$7,897,506	\$7,800,000	\$21,178,596	\$29,023,958	\$33,762,636	\$99,662,696
9		Total	\$177,623,629	\$169,397,941	\$141,789,273	\$122,175,332	\$113,407,814	\$724,393,989

(a) Project Numbers coincide with the project numbers listed in Appendix A, Table A-1.

All project costs are divided between facility upgrades (including existing facility rehabilitation and replacement) and expansion of capacity for the benefit of new customers. Municipal utility facilities are built with capacity to serve a decade or more

of projected demands, in order to reduce the overall unit cost of facilities to all customers. The City maintains a capital facility connection fee schedule for assessing new development with the cost of system-wide capacity so that "growth pays for itself" without burdening existing customers. However, the up-front expenditures on new facility construction always precedes the collection of connection fees, so the proposed bonds are sized to fund the total CIP expenditures. The anticipated connection fee proceeds of approximately \$14 million per year will be used to offset future Water Department capital expenditures, including the expansion-related portion of debt service. As such, the connection fee proceeds are recognized as non-operating revenue to the operating fund, and can be used for debt service and/or transferred to the capital program for "pay-go" project expenditures.

Detailed water system analyses are conducted periodically to identify and prioritize needed capital improvements. As a result, the finalized CIP schedule for FY 09 - 13 may differ slightly from Table 4-1 shown below for individual projects, but the overall difference in average annual CIP expenditures will be immaterial.

Some of the projects shown in Table 4-1 started before FY 09, and some projects will extend beyond FY 14. The proposed five-year CIP for FY 09 - 13 is \$724 million, including \$280 million for various pipeline projects to rehabilitate, replace, and expand distribution and transmission lines throughout the water system, and \$207 million for water treatment plant projects. Based on Water Department planning practices, approximately 80 percent of the expenditures will be bond funded, with the remaining 20 percent funded from annual revenues on a pay-as-you-go (pay-go) basis. However, depending on the cash available after net operating revenues, the City may in the future apply additional cash to project funding, which would alter this mix.

### **CIP Financing Plan**

Table 4-2 presents the flow of funds of the proposed capital financing plan, and summarizes the projected sources and uses of funds over the study period. This plan anticipates that proposed capital improvements will be financed from a combination of revenue bond proceeds, grants, transfers from net operating revenues, and interest income from the capital monies.

Table 4-2, line 19 provides an estimated beginning FY 09 balance of approximately \$170 million. A policy-based reserve target exists for capital emergencies of \$5 million, with the remaining funds available for capital project expenditures.



**Table 4-2**  
**Capital Project Sources and Uses, Flow of Funds**

Line No	Description	Fiscal Year Ending June 30				
		2009 (\$000s)	2010 (\$000s)	2011 (\$000s)	2012 (\$000s)	2013 (\$000s)
<b>1</b>	<b>Sources of Funds</b>					
2	New Bond Issues	400,435	0	123,535	205,765	0
3	Interest Earnings on Capital monies	4,638	4,067	2,489	4,827	5,042
4	Grant Receipts	8,000				
5	Policy-based Transfers in from Net Op Revs (a)	35,525	33,880	28,358	24,435	22,682
6	Total Source of Funds	448,598	37,946	154,382	235,027	27,724
<b>7</b>	<b>Use of Funds</b>					
8	Capital Improvement Program Project Expenditures	177,624	169,398	141,789	122,175	113,408
9	Transfer to Debt Service Reserve Fund (DSRF) (b)	29,091	0	8,975	14,949	0
10	Bond Issuance Costs	3,392	0	1,018	1,429	0
11	Capitalized Interest Cost for Deferred Debt Service	0				
12	Retire/Debase Existing Notes from Bond Proceeds (c)	207,000				
13	Total Use of Funds	417,106	169,398	151,782	138,553	113,408
<b>14</b>	<b>Net Sources and Uses of Funds</b>	31,492	(131,452)	2,601	96,474	(85,684)
<b>15</b>	<b>Cash Balance Detail</b>					
16	Beginning Fiscal Year Cash Balance					
17	Const Fund Balance (incl'd unrestricted funds, d)	164,786	196,278	64,826	67,427	163,901
18	Capital Emergency Reserve (set by City policy)	5,000	5,000	5,000	5,000	5,000
19	Total Beginning Balance	169,786	201,278	69,826	72,427	168,901
20	Net Sources and Uses of Funds	31,492	(131,452)	2,601	96,474	(85,684)
21	Ending Balance	201,278	69,826	72,427	168,901	83,217
<b>22</b>	<b>Debt Service Reserve Fund Held by Bond Trustees (DSRF)</b>					
23	Beginning Balance	47,312	76,403	76,403	85,378	100,326
24	Ending Balance	76,403	76,403	85,378	100,326	100,326
<b>25</b>	<b>DSRF Interest Earnings</b>	1,546	2,292	2,831	3,714	4,013
26	Planned CIP Cash Funding Percentage (e)	20%	20%	20%	20%	20%
(a) Transfers in are 20 percent of CIP expenditures.						
(b) The DSRF is held by the trustee and is listed separate from the capital program. The DSRF is equal to the minimum of 1) 10 percent of the proceeds, 2) 125 percent of the average annual debt service, or 3) maximum annual debt service. Assumes a 30 yr term at 6% interest. Interest from the DSRF is transferred to non-operating revenues.						
(c) Two private placement notes will be retired/debased during FY 09. The exact timing is not incorporated into this fiscal year level model, which coincides with the level of detail in the City's rate model.						
(d) Per discussion with City staff, beginning FY 09.						
(e) Funded with cash transfers from operating monies.						
Note: Debt service detail is shown in Table 4-8, and is presumed to start in the year following the year of issuance.						
Source: Future bond issues, grant receipts, and beginning fund balances from City rate model, 9/12/08.						

## Bond Financed Projects

Line 2 of Table 4-2 shows a total Series 2009 Bonds of \$400 million. This series will comprise two issues: A) to refund the 2007 Notes and B) to refund the 2008 Notes and help fund CIP expenditures. The total note refunding of \$207 million is shown on Line 12. Not shown herein is that if economically feasible the Series 2009 A Bond issue may be increased to refund a portion of all of the outstanding 1998 Bonds. Additional bonds are projected to be issued in FY 11 (\$124 million) and FY 12 (\$206 million).

We project that cash available from current net operating revenues will finance \$145 million of the CIP projects, or 20 percent of the total CIP. The Water Department targets funding 20 percent of the CIP with pay-go, with reserves, interest earnings and grants. Interest earnings are based on an estimated 2.5 percent earnings rate on average fund balances in FY 09; growing to 4.0 percent by FY 12. Interest earnings come from capital fund balances and reserves.

## **4.2 Water Service Revenues**

This subsection identifies the annual rate-based revenues based on the City Council approved water service rates and the projected customer demand levels.

### **Customer Service Charges**

City customers are grouped into basic residential, other domestic, commercial/industrial, and irrigation/temporary construction, interruptible agricultural and other classifications. Customers are charged a monthly fee based on meter size and a unique water commodity charge. Residential customers have an inclining block tiered commodity rate schedule to promote conservation awareness, while a uniform commodity rate is used with the other customer classes. The average commodity rate charged to each classification is based on the unique costs of serving their peak water demands, which vary both seasonally and diurnally. Current and projected water rates are shown in Table 4-3.

### **Projected Rate Increases**

The City Council has approved service rate increases of 6.5 percent in FY 10 and 11. Table 4-3 presents a summary of current and projected water rates incorporated into the financial projections. The unit rates in the table incorporate the CWA water supply purchase cost pass through adjustment and Indirect Potable Reuse (IPR) project temporary rate increase projected for FY 09. Based on City policy, the approved rates are updated semiannually by Council with CWA pass-through costs to reflect minor adjustments for actual versus projected water purchase costs imposed on the City by CWA. The IPR temporary rate increase expires at the end of FY 10 with the completion of the IPR study. As such, the funding of this pilot study for an alternative water supply is a temporary charge on the customer bills.

Unlike the unit rates for other customer classifications, the rates for interruptible agricultural customers are a function of MWD and CWA rate schedule policies, and are not projected to materially change. The Water Department updates its financial plan annually to determine if the projected level of revenues from proposed rate increases is appropriate for cashflow requirements and for meeting current and projected debt service coverage requirements.

**Table 4-3**  
**Current and Projected Rates and Charges**

Line No	Description	Fiscal Year Ending June 30				
		2009 Actual	2010 Approved	2011 Approved	2012 Projection	2013 Projection
1	<b>Rate Increase (a)</b>	6.50%	6.50%	6.50%	0.00%	0.00%
2	<b>Meter Base Fee (\$/month)</b>					
3	Less than 1 inch	\$16.52	\$17.59	\$18.73	\$18.73	\$18.73
4	1 inch	\$24.20	\$25.78	\$27.45	\$27.45	\$27.45
5	1 1/2 inch	\$41.76	\$44.47	\$47.37	\$47.37	\$47.37
6	2 inch	\$63.72	\$67.86	\$72.27	\$72.27	\$72.27
7	3 inch	\$115.29	\$122.79	\$130.77	\$130.77	\$130.77
8	4 inch	\$188.83	\$201.10	\$214.17	\$214.17	\$214.17
9	6 inch	\$371.02	\$395.14	\$420.82	\$420.82	\$420.82
10	8 inch	\$590.52	\$628.91	\$669.79	\$669.79	\$669.79
11	10 inch	\$847.35	\$902.43	\$961.08	\$961.08	\$961.08
12	<b>Commodity Charge (\$/HCF)</b>					
13	Single Family Domestic Customer					
14	1-7 HCF per month	\$2.80	\$2.98	\$3.07	\$3.07	\$3.07
15	8-14 HCF per month	\$3.03	\$3.23	\$3.33	\$3.33	\$3.33
16	15 + HCF per month	\$3.40	\$3.63	\$3.74	\$3.74	\$3.74
17	Other Domestic Customers	\$3.03	\$3.23	\$3.33	\$3.33	\$3.33
18	Commercial/Industrial	\$2.91	\$3.10	\$3.20	\$3.20	\$3.20
19	Irrigation/Temporary Construction	\$3.11	\$3.31	\$3.42	\$3.42	\$3.42
20	Interruptible Agricultural Rate	\$1.55	\$1.52	\$1.49	\$1.50	\$1.52
21	Other Utilities - Cal-American	\$1.95	\$2.08	\$2.21	\$2.21	\$2.21

(a) Rate increases include pass-through known and approved CWA water supply purchase costs and IPR rate adjustment that will go in effect mid-year FY 09. The rate increases do not include unknown future CWA supply costs that would increase the average bill.  
The IPR rate adjustment expires at the end of FY 10.  
Rate increases through FY 2011 have been approved by the City Council.  
CWA pass-through charges have always been approved by the City Council, in the past.  
Source: City rate model, 9/12/08.  
HCF = hundred cubic feet

As shown in Table 4-4, the Water Department has approximately 273,000 retail accounts, plus an additional 10,000 other water service customers included in rate-based revenue projections. These accounts serve approximately 1.3 million residents, as well as businesses and citywide institutions. Based on a projected annual population growth of approximately 1 percent, by FY 13 approximately 294,000 water accounts will be served by the City's Water Department.

Table 4-4  
Projected Potable Water Accounts

Line No	Meter Size	Fiscal Year Ending June 30				
		2009	2010	2011	2012	2013
1	Less than 1 Inch	234,762	237,307	239,687	242,068	244,449
2	1 Inch	23,109	23,360	23,594	23,829	24,063
3	1 1/2 Inch	10,908	11,026	11,136	11,247	11,358
4	2 Inch	12,670	12,807	12,936	13,064	13,193
5	3 Inch	421	426	430	434	439
6	4 Inch	474	479	484	488	493
7	6 Inch	224	226	228	231	233
8	8 Inch	104	105	106	107	108
9	10 Inch	41	41	42	42	42
10	Total Meters	282,712	285,777	288,643	291,510	294,377
11	Annual Growth	1.1%	1.1%	1.0%	1.0%	1.0%

Source: City rate model, 9/12/08

Table 4-5 summarizes the potable water consumption as projected by the City. The FY 09 and FY 10 estimated demands include a 15 percent voluntary reduction in response to a Stage 1 Voluntary Compliance Water Watch declaration by the City Council in July 2008. In FY 11 water consumption is expected to return to historical levels and remain stable. Interruptible agricultural demand is based on 5-year historical average consumption, and construction demands on 3-year historical consumption. Irrigation is forecasted to increase based on population growth and previous year usage. While the projected residential water demands are a function of population, the values also incorporate conservation in water use and a long-term reduction in average per capita water consumption. As such, although customer accounts are projected to increase about 1 percent per year, total consumption is limited to annual increases of about 0.8 percent. As shown, total potable water demand, estimated at 193,000 AF in FY 09, will increase to 234,000 AF by FY 13. These projected demands are the basis for water supply purchases from CWA, and excluded the six percent of water demand served by local water supply sources.

Table 4-5  
Projected Water Demand

Line No	Customer Classification	Fiscal Year Ending June 30				
		2009 MCF	2010 MCF	2011 MCF	2012 MCF	2013 MCF
1	Single Family Domestic	2,955	2,971	3,525	3,553	3,582
2	1-7 HCF	1,478	1,486	1,762	1,777	1,791
3	8-14 HCF	827	832	987	995	1,003
4	15 + HCF	650	654	775	782	788
5	Other Domestic	1,749	1,759	2,086	2,103	2,120
6	Commercial	1,884	1,894	2,247	2,265	2,283
7	Industrial	86	86	101	101	101
8	Outside City Services	1	1	2	2	2
9	Other Utilities - Cal-Am	527	530	629	634	639
10	Interruptable Agricultural	14	14	19	19	17
11	Irrigation	1,162	1,174	1,395	1,409	1,423
12	Construction Meters	23	23	26	26	26
13	Total, Potable Water Sales (MCF)	8,401	8,453	10,030	10,113	10,194
14	Total Potable Water Sales (AF)	192,871	194,049	230,251	232,167	234,027
15	Total Water Sales less Cal-Am (AF)	180,762	181,874	215,810	217,607	219,350
16	Annual Increase in Demand (b)		0.6%	18.7%	0.8%	0.8%
(a) Demands are for potable water supplies.						
(b) FY 2009 and 2010 water demands reflect a 15% reduction due to water shortage-related conservation measures.						
Source: City rate model, 9/12/08.						
MCF = Million Cubic Feet; AF = acre feet						

Table 4-6 presents the projected water revenues for the City. The base monthly fee revenue is based on the monthly meter fee (Table 4-3) times the number of accounts (Table 4-4). Consumption revenues are dependent on the projected demand (Table 4-5) and the commodity charge (Table 4-3). Estimated revenues for fire services and back flow fees are also included in the table, while reclaimed water sale revenues are provided in the following sections. Total annual rate-based revenues are expected to grow from \$309 million in FY 09 to \$416 million in FY 13, based on the approved rate increases, adoption of the FY 09 CWA pass-through and IPR adjustments, and the projected customer demands. The significant increase in FY 11 represents the increased post-drought water demand and the unit rate increase. If the drought continues and reduced demand extends beyond FY 10, revenues will be lower than projected. However, this will be offset to an extent by lower water purchase costs from CWA.

Table 4-6  
Current and Projected Revenues

Line No	Description	Fiscal Year Ending June 30				
		2009 (\$000s)	2010 (\$000s)	2011 (\$000s)	2012 (\$000s)	2013 (\$000s)
<b>Meter Base Revenues</b>						
1	Less than 1 Inch	46,246	50,089	53,880	54,415	54,950
2	1 Inch	6,665	7,226	7,773	7,850	7,927
3	1 1/2 Inch	5,423	5,885	6,330	6,393	6,456
4	2 Inch	9,607	10,429	11,218	11,330	11,441
5	3 Inch	578	627	675	682	688
6	4 Inch	1,064	1,155	1,243	1,255	1,268
7	6 Inch	987	1,073	1,154	1,165	1,177
8	8 Inch	727	790	850	858	867
9	10 Inch	411	447	480	485	490
10	Subtotal Base Fee Revenues	71,708	77,720	83,602	84,433	85,263
<b>Commodity Charge Revenues</b>						
Single Family Domestic Customer						
11	1-7 HCF	41,300	44,228	54,155	54,597	55,037
12	8-14 HCF	23,786	26,864	32,893	33,161	33,429
13	15 + HCF	20,984	23,696	29,016	29,253	29,488
14	Other Domestic Customers	50,285	56,794	69,539	70,106	70,671
15	Commercial/Industrial	54,297	61,310	75,024	75,610	76,194
16	Irrigation/Temporary Construction/Outside	34,886	39,608	48,533	49,027	49,497
17	Interruptible Agricultural Rate	203	215	290	287	266
18	Other Utilities - Cal-American	10,290	11,019	13,920	14,033	14,146
19	Subtotal Commodity Revenues	236,031	263,736	323,370	326,075	328,728
20	Fire Service/Backflow Fees	1,974	1,973	1,972	1,973	1,972
21	Total Rate-based Revenues (a)	309,713	343,429	408,943	412,480	415,964
22	Unit Rate Increase		6.5%	6.5%	0.0%	0.0%
23	Annual Account Growth		1.1%	1.0%	1.0%	1.0%
24	Annual Change in Water Demand (c)		0.6%	18.7%	0.8%	0.8%
25	Annual Increase in Rate-based Revenues		10.9%	19.1%	0.9%	0.8%
(a) Revenues are based on unit rates times demand. FY 09 revenues reflect CWA and IPR rate adjustments starting mid-year. FY 11 revenues reflect elimination of IPR rate adjustment. Unit rates are shown in Table 4-3. Revenues for reclaimed water are shown in Table 4-9.						
(c) The increase in water demand in FY 11 represents the return to normal demand after the 15% voluntary conservation-based reductions of FY 09 and FY 10.						
Source: Fire service/backflow fees from City rate model, 9/12/08. All remaining values calculated.						
HCF = Hundred cubic feet						

### 4.3 Water Department Expenditures

The Water Department revenues must be sufficient to meet the annual expenditures of ongoing operations and the capital program. Expenditures are funded on a prioritized basis as follows (1) total system operation and maintenance expenses; (2) debt service (consisting of principal and interest payments); (3) expenditures for major capital improvements met directly from revenues; and (4) provision for

adequate reserves. Projections of the cash requirements to meet these System expenditures for the period of FY 09 through FY 13 are developed in this section.

## Operation and Maintenance Expense

Operation and maintenance expense includes water purchases, total annual salaries and wages of personnel, and the costs of fringe benefits, materials and services, outlays (routine capital expenses) and transfers. Since these costs are essential for daily operations of the Water Department, they are funded on a priority basis from operating revenues, as they are incurred. A summary of total projected operation and maintenance expense for the period FY 09 through FY 13 is presented in Table 4-7. Wages, salaries and fringe benefits are expected to remain flat through FY 12 and then increase by four percent per year, based on regional economic and employment trends.

**Table 4-7**  
**Projected Operation and Maintenance Expense**

Line No	Expenditure	Fiscal Year Ending June 30				
		2009 (\$000s)	2010 (\$000s)	2011 (\$000s)	2012 (\$000s)	2013 (\$000s)
1	Water Supply Purchase Costs (a, b)	123,181	123,794	137,265	138,122	138,954
2	Salary & Wages	44,576	44,576	44,576	44,576	46,360
3	Fringe Benefits	23,621	23,621	23,621	23,621	24,566
4	Supply/Services/Other NPE	43,467	45,206	47,014	48,895	50,851
5	Outlay	857	891	927	964	1,003
6	Miscellaneous & Other (c)	28,397	42,632	39,277	39,918	39,393
7	Transfers to General Government Services	6,084	6,084	6,084	6,084	6,327
8	<b>Total O&amp;M</b>	<b>270,184</b>	<b>286,805</b>	<b>298,765</b>	<b>302,181</b>	<b>307,453</b>
(a) Water supply costs are based on FY 09 supply rates including pass-through cost escalations times projected demand.						
(b) FY 09 water purchase cost is per budget; the FY 09 and 10 water costs reflects the drought-induced (15%) conservation-oriented demand level; and FY 11 costs are based on a return to normal water demand levels.						
(c) Includes IPR costs.						
Source: City rate model, 9/12/08.						

The Water Department purchases the majority of its water needs from CWA with the remainder coming from local sources. CWA provides both raw and treated water based on operational considerations and long-term planning to minimize costs through an optimum use of regional facilities.

Costs for materials and supplies and outlays are conservatively expected to increase by four percent per year. Miscellaneous costs include the impact of new facilities on O&M activities, management information system (MIS) services and energy/utility expenditures. Energy/utility costs are forecasted to increase eight percent per year. The operation and maintenance expense is projected to increase from about \$270 million in FY 09 to \$307 million in FY 13, as shown in Table 4-7.

## Routine Capital Improvements

Expenditures for routine capital improvements include minor capitalized assets with short depreciation periods. These include items routinely acquired each year, such as vehicles and office equipment, and minor improvements or repairs. An allowance for construction and engineering costs to be expensed is also included in this category. Since the costs of these improvements are a continuing expense to be met each year, the Water Department appropriately finances these expenditures from current water revenues. As shown in Table 4-7, routine capital outlay is estimated to be \$857,000 in FY 09, and escalate at 4 percent per year through the projection period.

## Existing and Projected Debt Service

The Water Department's existing debt service schedule includes both senior and subordinate debt, as shown in Table 4-8. Bond assumptions and indices are also shown in Table 4-8. The Series 1998 bond issue was a senior debt issue. The Series 2002 Bonds, 2007 Notes, and 2008 Notes are subordinate lien issues as is the SRF Loan.

Table 4-8  
Existing and Projected Debt Service Schedule and Assumptions

Line No		Fiscal Year Ending June 30				
	Description	2009 (\$000s)	2010 (\$000s)	2011 (\$000s)	2012 (\$000s)	2013 (\$000s)
<b>Debt Service Schedule</b>						
1	Existing Senior Debt	21,354	12,089	12,089	12,089	12,089
2	Existing Subordinate Debt	24,895	30,128	27,293	27,296	27,299
3	Existing Subordinate SRF Debt	1,376	1,376	1,376	1,376	1,376
4	Proposed New Senior Debt		29,091	29,091	38,066	53,014
5	Total Existing & Proposed Debt	47,625	72,684	69,849	78,827	93,779
<b>Bond Cost of Issuance &amp; Insurance</b>						
6	New Bond Issue Par Value	400,435	0	123,535	205,765	0
7	Bond Issuance Costs	3,392	0	1,018	1,429	0
8	New Debt Service Reserve Requirements	29,091	0	8,975	14,949	0
<b>Bond Assumptions and Indices</b>						
9	Debt term (all years)	30				
10	Cost of issuance					
11	Discount (% of bond size)	0.50%	0.50%	0.50%	0.50%	0.50%
12	Fixed Cost of Issuance (\$1,000)	1,389	400	400	400	400
13	Earnings on Fund Balance	2.5%	3.0%	3.5%	4.0%	4.0%
14	Bond Interest Rate (a)	6.0%	6.0%	6.0%	6.0%	6.0%
(a) The bond interest rate is based on a projected market rate for municipal revenue bonds. DSRF interest earnings are not shown herein. Bond debt repayment starts in the year following bond issuance.						
Source of Existing Debt: City schedules.						



It is anticipated that the sale of the Series 2009 Bonds and additional bonds in FY 11 and FY 12 will be necessary to finance capital projects; the Series 2009 Bonds will refinance and/or defease \$207 million in existing notes, as well as finance CIP expenditures. As previously shown in Table 4-2, it is assumed that the Series 2009 Bonds will total some 400 million, and additional bonds will be issued amounting to \$124 million in FY 11 and \$206 million in FY12. The projected bond terms are for 30-years at a 6 percent interest rate, plus typical costs of issuance. As shown in Table 4-8, the projected costs associated with issuing new bonds include an underwriter discount and a fixed cost of issuance as well as deposits to the Debt Service Reserve Fund. Table 4-8 shows the projected debt service schedule for existing and proposed revenue bonds throughout the study period.

#### 4.4 Water Enterprise Revenues and Expenditures Proforma

Table 4-9 presents a proforma cashflow statement for the Water Department's projected revenues and expenditures during the study period. System revenues must be at least sufficient to fund the annual costs of operation and maintenance expense, debt service costs on existing and proposed bonds and routine annual capital improvements while maintaining adequate operating reserve funds and complying with all revenue bond debt service coverage requirements.

Table 4-9 identifies that the Water Fund has a FY 09 beginning year balance of \$204 million. This balance is associated with the operations, and is in addition to the capital monies previously identified in Table 4-2. The current reserves include:

<u>Reserve Type</u>	<u>Amount</u>	<u>Notes</u>
Operating	\$19,936,000	Currently 50 days, increasing to 70 days by FY 10
Secondary Purchase	\$7,132,000	6 percent of water purchase costs
SRF Loan	\$1,376,000	Fixed
Rate Stabilization Fund	\$20,500,000	Fixed

The Water Department has a policy of maintaining operation reserves equal to 45 days of O&M expenditures, excluding water purchase costs. The operating reserve policy is increasing to 70 days with the increase in rate-based revenues.

The rate stabilization fund was originally established by the Master Installment Purchase Agreement of August 1998, and a balance of such amounts as the City shall determine (currently \$20.5 million) is maintained in the fund. Transfers to or from the Rate Stabilization fund are treated as operating expenditures or operating revenues, respectively, and these transfers are included in the Pledged Revenues in the calculations of bond coverage ratios. The balance is available and pledged to augment funds available for annual debt service on the existing and proposed bonds.

**Table 4-9**  
**Water Utility Flow of Funds and Debt Service Coverage**

Line No	Description	2009 (\$000s)	2010 (\$000s)	2011 (\$000s)	2012 (\$000s)	2013 (\$000s)
<b>Operating Revenues</b>						
1	Water Service Rate-based Revenues (Proposed)	309,713	343,429	408,943	412,480	415,964
2	Reclaimed Water Service Revenues	7,876	8,304	9,472	10,307	11,148
3	Miscellaneous Service Charges	1,227	1,251	1,275	1,299	1,323
4	Other Operating Revenue (a)	19,245	19,611	19,984	20,363	20,750
5	Other Revenues	1,865	1,385	1,390	1,395	1,400
6	Total Operating Revenues	339,926	373,980	441,064	445,844	450,586
<b>Operating Expense</b>						
8	Water Purchase Costs	123,181	123,794	137,265	138,122	138,954
9	O&M Expenses	147,003	163,011	161,500	164,059	168,499
10	Total Operating Expense	270,184	286,805	298,765	302,181	307,453
11	Net Operating Revenues	69,742	87,175	142,299	143,664	143,133
<b>Non-Operating Revenues (Expenses) &amp; Transfers</b>						
13	Interest Income on Operating funds	5,167	6,323	8,647	12,682	15,302
14	Interest Income on DSRF	1,546	2,292	2,831	3,714	4,013
15	Projected Debt	(47,625)	(72,684)	(69,849)	(78,827)	(93,779)
16	Capacity Fee Proceeds	11,466	14,224	13,510	14,139	14,066
17	Pay-go Transfers to Capital Programs	(35,525)	(33,880)	(28,358)	(24,435)	(22,682)
18	Net Non-operating Revenues & Transfers	(64,971)	(83,725)	(73,219)	(72,727)	(83,079)
19	Annual Change in Cash Balance	4,771	3,450	69,080	70,937	60,053
<b>Cash Balance Detail (b)</b>						
21	Beginning Fiscal Year Cash					
22	Operating Reserves	19,936	31,262	30,973	31,463	32,315
23	Secondary Supply (water purchase reserve)	7,132	7,428	8,236	8,287	8,337
24	Rate Stabilization Fund	20,500	20,500	20,500	20,500	20,500
25	Subordinate SRF Loan Reserve	1,376	1,376	1,376	1,376	1,376
26	Unrestricted Cash	155,338	148,488	151,420	219,958	289,993
27	Total Beginning Fiscal Year Cash Balance	204,283	209,054	212,504	281,584	352,521
28	Net Annual Change in Cash Balance	4,771	3,450	69,080	70,937	60,053
29	Ending Fiscal Year Balance	209,054	212,504	281,584	352,521	412,575
<b>Operating Reserve Target per City Policy</b>						
31	Operations @ 70 days O&M exclud water purchase	28,192	31,262	30,973	31,463	32,315
32	Secondary Water Supply (c)	7,391	7,428	8,236	8,287	8,337
33	SRF Loan Reserve	1,376	1,376	1,376	1,376	1,376
(a) Other operating revenue includes land and building rentals, new water services, services rendered on other funds, other revenue, and lakes recreation.						
(b) Cash balances do not include Capital monies; refer to Table 4-2.						
(c) The Secondary Supply water reserve is set by City policy at 6 percent of the cost of water purchases.						
Source: Operating revenue except water sales, capacity fee proceeds, and beginning fund balances from City rate model, 9/12/08. All remaining values calculated:						

Table 4-9 presents the projected water service revenues incorporating both the existing and proposed rates. The proposed rates are part of the Water Department's long range financial plan developed by the financial planning model used by the Water Department.

The table shows that projected revenues are more than sufficient to meet the total revenue requirements of the system during the study period. Water service revenues represent the most significant source of revenues, averaging approximately 92 percent of total revenue; other operating revenues include reclaimed water service charges, miscellaneous revenues and interest income. Also included in revenues are the proceeds from land and building rentals, new water services and lakes recreation. Total operating expenses include water purchase costs and O&M expense, previously projected in Table 4-7.

Non-operating revenues included interest earned on operating fund balances, and system capacity charges. Capacity charges are expected to range between \$11.5 million and \$14.2 million per year over the study period. These revenues represent impact fee exactions from new customers who benefit from capacity created from expansion projects.

The primary non-operating expense is debt service. As previously discussed, we have projected that the Series 2009 A and B Bonds are sized at \$400 million, with additional bond issues of \$124 million in FY 11 and \$206 million in FY 12 to help finance major capital program expenditures and refinance and/or defease the Series 2007 and 2008 private placement notes. This debt financing provides a mechanism to spread the costs of major capital improvements over a portion of the useful life of the funded project and to more equitably recover the asset costs from both current and future users.

## 4.5 Debt Service Coverage

The single most important measurement of the ability of a utility to repay loans such as revenue bonds is the debt service coverage ratio. This ratio is defined in the bond covenant requirements of the current and proposed revenue bonds. Table 4-10 shows the coverage ratio on both the Senior and Aggregate bond debt service.

The City is required by the Installment Purchase Agreement to maintain 120 percent debt service coverage from pledged revenues on all existing and proposed senior lien debt. The senior debt service coverage test equals adjusted net revenues (which excludes interest earnings on reserve funds held by the bond trustees for parity obligations) divided by existing and proposed senior debt less the interest on the senior debt reserve fund. The aggregate debt service coverage equals the adjusted net revenues (including interest on the debt reserve fund) divided by the total existing and proposed debt.

Table 4-10 shows that senior debt service coverage is projected to meet or exceed 284 percent during the study period (FY 09 - FY 13). Aggregate debt service coverage is projected to meet or exceed 157 percent during the study period. These findings indicate that the Water Department has approved future customer service rates that will satisfy all debt service coverage requirements during the study period.

**Table 4-10**  
**Water Utility Debt Service Coverage**

Line No	Description	Fiscal Year Ending June 30				
		2008 (\$000s)	2009 (\$000s)	2010 (\$000s)	2011 (\$000s)	2012 (\$000s)
1	Senior Debt Service Coverage					
2	Net Operating Revenues (a)	43,862	69,742	87,175	142,299	143,664
3	Interest Income on Operating Funds	8,268	5,167	6,323	8,647	12,682
4	Interest Income on Capital Monies (b)	2,465	5,187	4,725	3,257	5,704
5	Capacity Fee Proceeds	8,459	11,466	14,224	13,510	14,139
6	Total Adjusted Net System Revenues (c)	63,053	91,561	112,447	167,713	176,190
7	Projected Senior Debt Service	21,354	21,354	41,180	41,180	50,155
8	Senior DSRF Interest (d)	1,370	998	1,634	2,063	2,837
9	Adjusted Debt Service	19,984	20,356	39,546	39,117	47,318
10	Senior Debt Service Coverage (c)	316%	450%	284%	429%	372%
11	Aggregate Debt Service Coverage					
12	Net Operating Revenues	43,862	69,742	87,175	142,299	143,664
13	Interest Income on Operating Funds	8,268	5,167	6,323	8,647	12,682
14	Interest Income on Capital Monies	1,922	4,638	4,067	2,489	4,827
15	Capacity Fee Proceeds	8,459	11,466	14,224	13,510	14,139
16	Debt Service Reserve Fund Interest	2,435	1,546	2,292	2,831	3,714
17	Total Net System Revenues	64,945	92,559	114,081	169,776	179,026
18	Projected Senior Debt Service	21,354	21,354	41,180	41,180	50,155
19	Projected Subordinate Debt Service	21,728	26,271	31,504	28,668	28,672
20	Aggregate Debt Service (e)	43,082	47,625	72,684	69,849	78,827
21	Aggregate Debt Coverage (f)	151%	194%	157%	243%	227%

(a) FY 09 & FY 10 figures reflect an anticipated 15% water conservation. Thereafter, figures reflect pre-water conservation levels. Includes service charges and reclaimed water sales. Includes revenues generated by purchase water cost increases that were affected as a result of rate increases implemented by CWA. Reflects treated water purchases, which do not include unknown future rate increases due to potentially increasing CWA supply costs.

(b) Includes interest income on Subordinate DSRF.

(c) As defined in the Installment Purchase Agreement.

(d) Includes anticipated bond issuances subsequent to FY 09.

(e) Includes Senior obligations, Subordinated obligations, and SRF debt service without adjustment for DSRF earnings.

(f) Ratio of total Net System Revenues to Aggregate Debt Service.

## 4.6 Operating Reserves

The Water Department currently maintains an operating reserve target equal to 45 days of O&M expenses, excluding water purchase costs. This target is scheduled to increase to 70 days with the increase in rate-based revenues. Currently, the water operating fund reserves equal 50 days of operating costs. The projected operating reserve will meet the 70 day target level by FY 10.

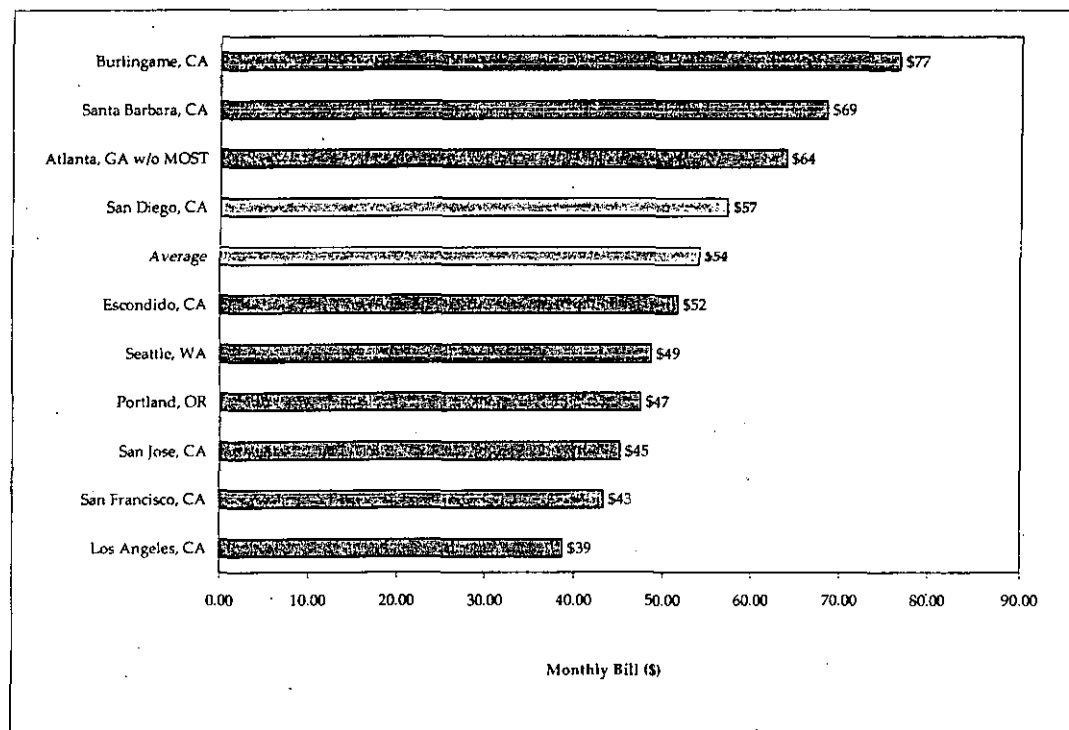
## 4.7 Affordability

A 2006 American Community Survey conducted by the US Census Bureau stated the median household income in San Diego County was almost \$58,815. The typical monthly water bill of \$57 for an average single family residence that will be effective in FY 09 represents 1.2 percent of this median household income. As such, the projected monthly bill is below the 2.0 percent median household income baseline

used as a typical industry standard for affordability by the U.S. Environmental Protection Agency.

## 4.8 Water Bill Comparison

Figure 4-1 presents a comparison of typical water service bills for various water utilities. The comparison of water utilities represent either utilities serving high population cities or utilities serving large cities in California near or on the coast with imported supplies. The water bills are based on current rates (as of September 2008) assuming a water flow of 14 hundred cubic feet per month with a meter size of less than 1 inch. The monthly water bill for an average San Diego single family residential customer is estimated to be \$57.30 per month, effective July 1, 2008.



(a) These bills are based on water use of 14 HCF per month and a meter size of less than 1 inch.

Figure 4-1  
Comparison of Monthly Water Bills with Other Cities (a)

## Section 5

### Parity Obligation (Additional Bonds) Test

A condition for the issuance of the additional bonds projected in this analysis is a certification that the City complies with the Parity (or Subordinate) Obligations test, as provided in the Installment Purchase Agreement. As provided in the Agreement, the City is required to meet one of two Obligation tests. Both tests examine the coverage ratio of the Water Department's pledged revenues to the total existing and proposed bonded debt. The first test is a historical test, and is based on any 12 consecutive month period within the 18 consecutive months prior to the proposed bond issuance. The second (alternative) test is based on a five year forecast of the coverage ratio. The tests differ slightly for parity versus subordinated bonds.

As shown in Table 5-1 on the following page, the Water Department meets the historical coverage test.

The historical coverage test allows the Water Department to use data from any 12 month consecutive period within the 18 consecutive months ending immediately prior to the incurring of additional Parity Obligations. The Water Department can rely upon financial statements prepared by the City that have not been subject to audit by an independent certified public accountant if audited financial statements for the period are not available. The data used in the historical coverage test in Table 5-1 is derived from the unaudited financial statements of FY 08, which ended on June 30, 2008.

The historical coverage test requires that the Water Department demonstrate that during the 12-month period the Net System Revenues are at least 1.20 times the Maximum Annual Debt Service on all Parity Obligations to be Outstanding immediately after the issuance of the proposed Parity Obligations or at least 1.00 times the Maximum Annual Debt Service on all Obligations to be Outstanding immediately after the issuance of the proposed Parity Obligations.

All capitalized terms used in this Section 5 that are not otherwise defined herein have the meanings given such terms in the Installment Purchase Agreement.

**Table 5-1**  
**Historical Additional Bonds Test**

Line No	Description	FY 2008 (\$000s)
1	Operating Receipts	
2	Water Sales (a)	288,949
3	Other Services	9,564
4	Rentals	5,695
5	Other Revenue	2,992
6	Total Operating Receipts	307,200
7	Operating Expenditures	
8	Water Purchases	128,114
9	Operations and Maintenance	135,225
10	Total Operating Expenditures	263,339
11	Operating Income	43,862
12	Other Income	
13	Interest Earnings	12,625
14	Capacity Charges	8,459
15	Other Income (b)	2,746
16	Total Other Income	23,829
17	Net Income	67,691
18	Less: DSFR Earnings on Parity Obligations	1,370
19	Adjusted Net System Revenue	66,321
20	Maximum Annual Debt Service on all Parity Obligations	54,466
21	Test (c)	1.22
(a) Includes Service Charges and Reclaimed Water Sales		
(b) Includes cancelled prior year encumbrances, recovered damages, land sales		
(c) Ratio of Net System Revenue to Parity Obligations $\geq 1.20$		

Appendix A  
Proposed Capital Improvement Plan  
Projects



**Table A-1**  
**Proposed Capital Improvement Plan Projects**

Line #	PROJECT	PROJECT TYPE	Current Phase as of Sept. 2008	FY2009	FY2010	FY2011	FY2012	FY2013
1	Alvarado WTP Expansion Phase 2	Water Treatment Plant	close-out	\$ 260,000	\$ -	\$ -	\$ -	\$ -
2	Alvarado WTP-SD12	Water Treatment Plant	planning	\$ -	\$ 119,444	\$ 184,632	\$ 221,311	\$ 2,521,848
3	Alvarado WTP-Ozone Improv	Water Treatment Plant	construction	\$ 21,981,620	\$ 23,453,520	\$ 9,790,666	\$ 314,072	\$ -
4	Alvarado WTP Rehab Floc/Sed Basin Ph3	Water Treatment Plant	design	\$ 3,387,234	\$ 21,622,888	\$ 5,296,723	\$ -	\$ -
5	Miramar WTP SDFCF 24, 25, 26	Water Treatment Plant	planning	\$ 463,865	\$ 1,137,841	\$ 3,618,022	\$ 100,143	\$ 12,326
6	Miramar WTP Contract B - Floc/Sed Basin	Water Treatment Plant	construction	\$ 33,574,060	\$ 14,954,826	\$ -	\$ -	\$ -
7	Miramar WTP Contract D - Landscape & Site Impr	Water Treatment Plant	design	\$ 75,679	\$ 21,322	\$ 3,868,217	\$ 826,341	\$ 501
8	Miramar WTP Contract C - Ozone Equip/Install	Water Treatment Plant	construction	\$ 14,679,265	\$ 9,841,329	\$ -	\$ -	\$ -
9	Otay WTP Upgrade Phase 1 (Floc/Sed Basin & Reh )	Water Treatment Plant	construction	\$ 7,949,200	\$ 7,978,478	\$ 5,664,644	\$ 171,099	\$ -
10	Otay WTP Upgrade Phase 2	Water Treatment Plant	construction	\$ 4,385,097	\$ 4,751,556	\$ 2,887,505	\$ 6,423	\$ -
11	Otay WTP Upgrade Phase 3	Water Treatment Plant	planning	\$ -	\$ -	\$ -	\$ -	\$ 1,251,452
12	Miramar Clearwell Improvements	Water Treatment Plant	planning	\$ -	\$ -	\$ -	\$ -	\$ 118,934
				\$ 86,756,020	\$ 83,881,204	\$ 31,310,409	\$ 1,639,389	\$ 3,905,061
13	AA - Freeway Relocations	Pipelines	various	\$ 35,569	\$ 50,000	\$ 50,000	\$ 50,000	\$ 50,000
14	AA - Water Main Replacements	Pipelines	various	\$ 36,630,050	\$ 43,264,000	\$ 44,994,560	\$ 46,794,344	\$ 48,666,116
15	Miramar Pipeline Monitoring	Pipelines	planning	\$ 67,576	\$ 578,261	\$ 649,106	\$ 200,152	\$ -
16	Torrey Pines Rd/La Jolla Blvd - Phase 2	Pipelines	completed	\$ 14,695	\$ -	\$ -	\$ -	\$ -
17	La Jolla Shores Dr. 16" Water Main Repl.	Pipelines	planning	\$ -	\$ -	\$ 259,158	\$ 1,432,365	\$ 518,077
18	Harbor Drive Pipeline	Pipelines	planning	\$ 168,179	\$ 254,395	\$ 2,621,371	\$ 6,500,955	\$ 123,905
19	El Capitan Pipeline No. 2	Pipelines	planning	\$ -	\$ -	\$ 1,049,917	\$ 1,407,332	\$ 1,975,936
20	El Monte Pipeline No. 2	Pipelines	planning	\$ -	\$ -	\$ 2,449,693	\$ 2,889,454	\$ 4,943,735
21	Kearny Mesa Pipeline Upgrade	Pipelines	planning	\$ -	\$ -	\$ 1,111,866	\$ 1,308,380	\$ 2,247,061
22	Caltrans Relocation Miramar	Pipelines	Construction	\$ 568,000	\$ 7,664	\$ 333	\$ -	\$ -
23	CALTRANS-W.Bernardo Dr-I1	Pipelines	Close-out	\$ 364	\$ -	\$ -	\$ -	\$ -
24	SR125 - Toll Road	Pipelines	Close-out	\$ 56,678	\$ -	\$ -	\$ -	\$ -
25	CALTRANS - 1905	Pipelines	Design	\$ 9,765	\$ 2,791	\$ -	\$ -	\$ -
26	CALTRANS-El Monte-RTE 67	Pipelines	Construction	\$ 42,872	\$ 41,311	\$ 4,198	\$ -	\$ -
27	Caltrans Carroll Canyon and I-15 Potable Water	Pipelines	Construction	\$ 1,071,565	\$ 3,742	\$ -	\$ -	\$ -
28	Caltrans Carroll Canyon and I-15 Reclaimed Water	Pipelines	Construction	\$ 1,868,025	\$ 2,850	\$ -	\$ -	\$ -
29	Pomerado Pipeline No. 2	Pipelines	planning	\$ -	\$ 11,669	\$ -	\$ -	\$ -
30	Otay 2nd Pipeline - Isolate Service Sweetwater	Pipelines	planning	\$ -	\$ -	\$ 99,716	\$ 269,350	\$ 453,352
31	Otay 2nd Pipeline - Cathodic Protect Otay Ranch	Pipelines	planning	\$ -	\$ -	\$ -	\$ 24,377	\$ 40,231
32	Otay 2nd Pipeline - Cast Iron Replacement Phase	Pipelines	construction	\$ 8,367,217	\$ 2,782,752	\$ -	\$ -	\$ -
33	Otay 2nd Pipeline - North Encanto Replacement	Pipelines	construction	\$ 4,523,186	\$ 523,098	\$ -	\$ -	\$ -
34	Lindbergh Field 16in Cast Iron Replacement	Pipelines	planning	\$ -	\$ 107,061	\$ 120,221	\$ 553,600	\$ 4,578
35	La Jolla/Pacific Beach-WTR	Pipelines	planning	\$ 2,427	\$ -	\$ -	\$ -	\$ -
36	Fault Crossing Retrofits to Large Pipelines	Pipelines	design/construction	\$ 1,413,234	\$ 211,865	\$ -	\$ -	\$ -
37	Landslide/Liquefaction Pipeline Mitigation	Pipelines	design/construction	\$ 2,865,807	\$ 233,162	\$ -	\$ -	\$ -
				\$ 57,705,209	\$ 48,074,621	\$ 53,410,139	\$ 61,430,309	\$ 59,022,991

**Table A-1**  
**Proposed Capital Improvement Plan Projects**

Line #	PROJECT	PROJECT TYPE	Current Phase as of Sept. 2008	FY2009	FY2010	FY2011	FY2012	FY2013
38	AA - Water Pump Station Rehabilitations	Pump Station	various	\$ -	\$ -	\$ 500,004	\$ 500,004	\$ 500,000
39	Tierrasanta (Via Dominique) Pump Station	Pump Station	planning	\$ -	\$ 90,346	\$ 126,684	\$ 132,365	\$ 573,278
40	Soledad Pump Station Upgrade	Pump Station	planning	\$ -	\$ -	\$ -	\$ -	\$ 101,911
41	Scripps Miramar Pump Station Upgrade	Pump Station	planning	\$ -	\$ -	\$ 204,687	\$ 108,476	\$ 238,653
42	Tierrasanta Norte Water Pump Station	Pump Station	planning	\$ -	\$ -	\$ -	\$ 18,620	\$ 36,396
43	Rancho Penasquitos Pump Station	Pump Station	construction	\$ 9,550,000	\$ 3,750,446	\$ -	\$ -	\$ -
44	Serra Mesa Pump Station	Pump Station	planning	\$ -	\$ -	\$ -	\$ 115,848	\$ 374,620
45	Parkland Pump Station	Pump Station	planning	\$ -	\$ -	\$ -	\$ 1,563,416	\$ 1,699,118
				\$ 9,550,000	\$ 3,840,792	\$ 831,375	\$ 2,438,729	\$ 3,523,976
46	AA - Standpipes and Reservoirs	Storage Facility	various	\$ -	\$ -	\$ 500,004	\$ 500,004	\$ 500,000
47	AA - Dams and Reservoirs	Storage Facility	various	\$ 146,847	\$ 250,000	\$ 250,000	\$ 250,000	\$ 250,000
48	Barrett Reservoir Outlet Tower Upgrade	Storage Facility	construction	\$ 1,639,374	\$ 3,333	\$ -	\$ -	\$ -
49	El Capitan Reservoir Rd Improvements	Storage Facility	planning	\$ -	\$ -	\$ -	\$ 23,153	\$ 3,327,049
50	Morena Reservoir Outlet Tower Upgrade	Storage Facility	planning	\$ -	\$ -	\$ -	\$ 1,013,343	\$ 2,334,035
51	Rancho Bernardo Reservoir Upgrade	Storage Facility	construction	\$ 4,461,387	\$ -	\$ -	\$ -	\$ -
52	Lower Olay Reservoir - Emergency Outlet Improvmt	Storage Facility	design	\$ 447,628	\$ 160,292	\$ 589,037	\$ 1,876,898	\$ 1,894,959
53	Pomerado Park Reservoir Upgrade	Storage Facility	planning	\$ -	\$ -	\$ 64,896	\$ 167,044	\$ 682,869
54	Paradise Mesa Standpipe Rehabilitation	Storage Facility	planning	\$ -	\$ -	\$ -	\$ -	\$ 195,674
55	La Jolla View Reservoir	Storage Facility	planning	\$ -	\$ -	\$ -	\$ 101,064	\$ 467,763
56	La Jolla Exchange Place Reservoir	Storage Facility	planning	\$ -	\$ -	\$ -	\$ -	\$ 1,742
57	La Jolla Country Club Reservoir Seismic Upgrade	Storage Facility	planning	\$ -	\$ -	\$ -	\$ 149,185	\$ 245,005
58	Murray Outlet Tower	Storage Facility	planning	\$ -	\$ -	\$ -	\$ 10,332	\$ 148,029
59	San Carlos Reservoir Interior Enhancement	Storage Facility	planning	\$ -	\$ 493,575	\$ 43,707	\$ -	\$ -
60	Lake Hodges Dam Modification	Storage Facility	planning	\$ 99,186	\$ 35,389	\$ 75,025	\$ 40,410	\$ 483,557
61	Morena Dam Grotto	Storage Facility	planning	\$ -	\$ -	\$ -	\$ 77,475	\$ 452,533
				\$ 6,794,422	\$ 942,589	\$ 1,522,669	\$ 4,208,908	\$ 10,983,215
62	AA - Pooled Contingencies - RWDS	Reclaimed Pipelines	various	\$ 250,000	\$ 500,000	\$ 500,000	\$ 500,000	\$ 500,000
63	AA - Reclaimed Water Extension	Reclaimed Pipelines	various	\$ 1,000,000	\$ 500,000	\$ 500,000	\$ 500,000	\$ 500,000
64	Black Mountain Ranch Reclaimed Water Storage Tank	Reclaimed Pipelines	completed	\$ 2,500	\$ -	\$ -	\$ -	\$ -
65	Carmel Valley Reclaimed Water Pipeline	Reclaimed Pipelines	design	\$ 100,000	\$ 1,096,060	\$ 4,566,017	\$ 1,872,039	\$ -
66	Los Penasquitos Canyon RW Project	Reclaimed Pipelines	design	\$ 140,000	\$ 3,270,969	\$ 973,308	\$ 108,185	\$ -
67	Pacific Highlands RWP - Participation Agreement	Reclaimed Pipelines	design	\$ 1,023,508	\$ 137,953	\$ -	\$ -	\$ -
68	Camino Del Sur RWP - E&CP	Reclaimed Pipelines	design	\$ 166,506	\$ 631,509	\$ 483,707	\$ -	\$ -
69	Camino del Sur Recycled Water P/L- Part Agmt	Reclaimed Pipelines	design	\$ 422,092	\$ 969,610	\$ 391,369	\$ -	\$ -
				\$ 3,104,606	\$ 7,106,101	\$ 7,414,401	\$ 2,980,224	\$ 1,000,000
70	Mission Valley Groundwater Desalination	Groundwater	planning	\$ -	\$ -	\$ -	\$ 1,020,814	\$ 885,349
71	San Pasqual Brackish Groundwater Desalination Demo	Groundwater	design	\$ 1,193,982	\$ 1,463,612	\$ -	\$ -	\$ -
72	San Pasqual Brackish Desalination	Groundwater	planning	\$ -	\$ 5,181,976	\$ 18,352,782	\$ 19,106,706	\$ 74,129
73	San Diego Formation Desalination	Groundwater	planning	\$ -	\$ -	\$ -	\$ -	\$ 250,457
74	Groundwater Pilot Production Wells	Groundwater	planning	\$ 825,834	\$ 998,046	\$ 176,126	\$ -	\$ -
				\$ 2,019,816	\$ 7,643,634	\$ 18,528,908	\$ 20,127,520	\$ 1,209,935

**Table A-1**  
**Proposed Capital Improvement Plan Projects**

Line #	PROJECT	PROJECT TYPE	Current Phase as of Sept. 2008	FY2009	FY2010	FY2011	FY2012	FY2013
75	SD 17 Flow Control Facility (Alvarado)	Security	design	\$ 3,180,180	\$ 9,602,958	\$ 5,674,242	\$ 230,042	\$ -
76	Water Dept. Security Upgrades	Security	design	\$ 535,400	\$ 506,042	\$ 1,918,534	\$ 96,253	\$ -
77	Water Dept. Security Upgrades - Miramar	Security	design	\$ 80,470	\$ -	\$ -	\$ -	\$ -
				\$ 3,796,050	\$ 10,109,000	\$ 7,592,776	\$ 326,295	\$ -
78	AA - Corrosion Control	Miscellaneous	various	\$ -	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000
79	AA - Pooled Contingencies - Water	Miscellaneous	various	\$ 7,000,000	\$ 7,000,000	\$ 7,000,000	\$ 7,000,000	\$ 7,000,000
80	AA - Meter Boxes	Miscellaneous	various	\$ 500,000	\$ 500,000	\$ 500,000	\$ 500,000	\$ 500,000
81	AA-Pressure Reducing Stations	Miscellaneous	various	\$ 200,000	\$ 200,000	\$ 500,000	\$ 1,000,000	\$ 1,000,000
82	Miramar Service Area Improvements	Miscellaneous	planning	\$ -	\$ -	\$ 3,000,000	\$ 10,000,000	\$ 10,000,000
83	Alvarado Service Area Improvements	Miscellaneous	planning	\$ -	\$ -	\$ 10,000,000	\$ 10,000,000	\$ 10,000,000
84	Otay Service Area Improvements	Miscellaneous	planning	\$ -	\$ -	\$ -	\$ -	\$ 5,000,000
85	Kensington Pressure Regulator	Miscellaneous	planning	\$ -	\$ -	\$ -	\$ 329,788	\$ 7,977
86	Alvarado Water Quality Lab Roof Replacement	Miscellaneous	close-out	\$ 197,506	\$ -	\$ -	\$ -	\$ -
87	Barrett Flume Cover	Miscellaneous	planning	\$ -	\$ -	\$ 78,596	\$ 94,170	\$ 154,659
				\$ 7,897,506	\$ 7,800,000	\$ 21,178,596	\$ 29,023,958	\$ 33,762,636
				\$ 177,623,629	\$ 169,397,941	\$ 141,789,273	\$ 122,175,332	\$ 113,407,814

**Table A-2**  
**Capital Improvement Plan Project Descriptions**

	CIP Project	Project Type	Description
1	Alvarado WTP Expansion Phase 2	Water Treatment Plants	This CIP item closes out the expansion phase of the Alvarado Water Treatment Plant project. The plan is to upgrade and expand the Alvarado WTP to its ultimate capacity of 200 mgd to meet the 2015 water demands in several phases. The first phase increased the capacity of the WTP to 150. Phase 2 increases the capacity to 200 mgd by providing additional flocculation and sedimentation basins and new controls for the original eight gravity filters.
2	Alvarado WTP SD12	Water Treatment Plants	Upgrade & expansion of CWA's flow control facility to 150 mgd. Another 50 mgd will be provided from San Vicente through El Monte pipeline and Lake Murray Reservoir to provide 200 mgd total plant capacity. Two (size to be determined) Pressure Sustaining Valves would be installed and used with two existing 16-inch Pressure Sustaining Valves within the existing Meter and Pressure Control Structure.
3	Alvarado WTP-Ozone Improv Ph 4 Ozone	Water Treatment Plants	Construction of ozone disinfection and pumping facilities to meet new Federal Safe Drinking Water requirements and State of California Department of Health Services compliance order, and the associated process changes to make ozone the primary water disinfectant and chlorine secondary.
4	Alvarado WTP Rehab Flocc/Sed Basins Ph 3	Water Treatment Plants	This project consists of rehabilitation of Flocculation/Sedimentation Basins 1 & 2, as well as installation of Ozone pipeline from Ozone Building through the exiting basins to the existing filter.
5	Miramar WTP SDFCF 24, 25, 26	Water Treatment Plants	In order to meet capacity of the Miramar WTP Upgrade and Expansion (MWTP) project from 140 MGD to 215 MGD, it is necessary to upgrade CWA's existing flow control facility (5A/5B/5C) to increase capacity of raw water to MWTP.
6	Miramar WTP Contract B - Flocc/Sed Basin	Water Treatment Plants	This project will expand the plant capacity from 140 mgd to 215 mgd to meet water demands through 2030. The construction scope of work will involve: Construction of 4 new Flocculation and Sedimentation basins 5, 6, 7 and 8 inclusive of associated piping - Demolition of the twelve existing filters - Demolition of the existing backwash water tank and associated piping - Demolition of the existing Flocculation and Sedimentation basins - Construction of 60 inch influent pipelines to New Flocculation Basins - Construction of 108 inch & 120 inch settled water pipelines
7	Miramar WTP Contract D - Landscape & Site Improvement	Water Treatment Plants	This project consists of final Water Treatment Plant site landscaping, irrigation, parking, paving and new Guard Shack and site entrance.

**Table A-2  
Capital Improvement Plan Project Descriptions**

	<b>CIP Project</b>	<b>Project Type</b>	<b>Description</b>
8	Miramar WTP Contract C - Ozone Equip/Install	Water Treatment Plants	This project consists of installation of Ozone equipment and Liquid Oxygen delivery and storage facilities. Three Ozone generators will be provided to generate ozone for supply and distribution of ozonated feed gas to four ozone contactors. Once this project is completed, ozone will replace chlorine as the primary disinfectant.
9	Otay WTP Upgrade Phase 1	Water Treatment Plants	The Otay WTP Upgrades Phase 1 project will construct a new flocculation and sedimentation basin and make improvements to the sixteen existing filters. The filters improvements include granular activated carbon (GAC) filtration media and providing a pumped backwash system, a filter to waste system, replacing the filter under drains and increasing the media depth.
10	Otay WTP Upgrade Phase 2	Water Treatment Plants	The Phase 2 upgrades to the Otay WTP include construction of a chlorine dioxide shaft contactor, ClO2 generation system, sodium chlorite tank, ferrous chloride (FeCl2) tanks and feed system, powder activated carbon (PAC) facilities, reservoir circulator units, yard piping, electrical support facilities, instrumentation and controls systems, and associated site work.
11	Otay WTP Upgrade Phase 3	Water Treatment Plants	The Otay WTP upgrades Phase 3 project will construct four new filters; rehabilitate the two existing flocculation and sedimentation basins by adding plate settlers, launders and a new sludge collection system; provide an additional ultraviolet disinfection system reactor; and construct the seismic improvements identified in the Seismic Vulnerability Assessment.
12	Miramar Clearwell Improvements	Water Treatment Plants	The project is based on the rehabilitation of the clearwell roof to address structural issues and upgrade overflow to pass the total flow from the plant (current overflows will only pass approximately 40 mgs before the water surface in the clearwells reaches the underside of the roof supports). The other option for this project would be to demolish the existing clearwells and construct new ones which require \$30 million. We also want to evaluate the need to add clearwell storage. Roof and related: \$6,500,000.
13	AA - Freeway Relocations	Pipelines	This project provides for relocation of water lines in conflict with California Department of Transportation highway construction program.
14	AA-Water Main Replacements	Pipelines	This project replaces aged cast iron water mains

**Table A-2  
Capital Improvement Plan Project Descriptions**

	<b>CIP Project</b>	<b>Project Type</b>	<b>Description</b>
15	Miramar Pipeline Monitoring	Pipelines	The condition of the Miramar Pipeline was originally assessed in 2005 under the Miramar Pipeline Rehabilitation Project (Phases III and IV), using an inspection technology known as the Remote Field Eddy Current/ Transformer Coupling (RFEC/TC) to identify and locate pre-stressing wire failures in the pipe wall. Miramar Pipeline Monitoring Project was created based on the results of the Miramar Pipeline Rehabilitation Project (phases III and IV), which recommended that the city perform RFEC/TC inspection of phases III and IV within approximately 5 years of the original inspection performed in early 2005. The Miramar Pipeline Monitoring project is scheduled to begin FY2009. Phase III will consist of inspecting approximately 17, 000 feet of 51-inch and 54-inch pipe along Mira Mesa Boulevard from Pacific Heights Blvd eastward to Westonhill Drive. While phase IV will consist of inspecting approximately 12,000 feet of pipe eastward from the intersection of Westonhill Drive and Mira Mesa Blvd to the Miramar Water Treatment Plant. Pipe diameters in this section range from 60 inches to 66-inches.
16	Torrey Pines Rd/La Jolla Blvd.-Phase 2	Pipelines	Replace ± 31,900 linear feet of 16-inch diameter Cast Iron Water Main. The construction will be done in multiple phases and at times to minimize the construction impact on the area, and in compliance with restrictions relating to when construction can be done in this area. Phase 2 replaces ± 21,200 linear feet of 16-inch Cast Iron Water Main in the La Jolla and Pacific Beach Area. The construction will be divided into three segments. Segment A starts from the intersection of Torrey Pines Road and Exchange Place and travels west on Torrey Pines Road, then turns south on Girard Avenue to Pearl Street (approximately 2,434 feet). Segment B continues from Girard Avenue on Pear Street, heads southwest to Fay Avenue to Westbourne Street, and back to La Jolla Blvd, then terminates at Mesa Way (approximately 6,936 feet).
17	La Jolla Shores Dr. 16" Water Main Repl.	Pipelines	This project is the 3rd phases of the Torrey Pines Blvd Pipeline. It proposes to replace ± 4,410 linear feet of 16-inch Cast Iron Water Main along La Jolla Shores Dr in the La Jolla Area.
18	Harbor Drive Pipeline	Pipelines	This project replaces the remaining portions of 16-inch cast iron water main located along Harbor Drive from Point Loma to San Diego Bay.
19	El Capitan Pipeline No. 2	Pipelines	Hydraulic analysis to determine if the size is adequate to meet the demandsCondition assessment with internal and external inspectionBased on the findings of the Condition assessment, if sections need to be replaced we will either parallel or replace in place

**Table A-2**  
**Capital Improvement Plan Project Descriptions**

	<b>CIP Project</b>	<b>Project Type</b>	<b>Description</b>
20	El Monte Pipeline No. 2	Pipelines	This project would build a new 60-inch pipeline with capacity of 150 mgd between the Lakeside Pump Station and the Alvarado WTP.
21	Kearny Mesa Pipeline Upgrade	Pipelines	Replacement of the Kearny Mesa Pipeline. The existing pipeline was constructed in 1950 and has reached its useful service life. This is an upgrade and replacement of the 36-inch pipeline and will create interconnect for redundancy.
22	Caltrans Relocation Miramar	Pipelines	Caltrans is expanding the bridge crossing at Carroll Canyon and I-15, water lines on the bridge will need replaced with construction, pipeline will be relocated to Maya Linda.
23	CalTrans-W.Bernardo Dr-I1	Pipelines	The State of California (Caltrans) is demolishing and replacing the Highland Valley Rd (West Bernardo Drive) bridge to accommodate a four lane High Occupancy Vehicle Road. The City owns and maintains a 12-inch water main under the bridge. Caltrans will remove and replace the water main as part of its construction contract at City's expense.
24	CalTrans SR125 - Toll Road	Pipelines	Caltrans is constructing a portion of SR125 in San Diego County from SR905 to SR54. Construction of the highway requires the relocation of a portion of the Otay II and III potable water lines. Since the City has prior rights, Caltrans is required to relocate the lines at its expense. Pipelines will be relocated in the same aligned but further below the surface and will be upsized to 54".
25	CALTRANS - I905	Pipelines	Caltrans will relocate the existing 24 inch steel pipe crossing I-905 to Airway Rd. and connect back to Caliente Blvd.
26	CalTrans-EL Monte-Rte 67	Pipelines	Caltrans will be extending State Route 52 east from State Route 125 to State Route 67 in the City of Santee. The Water Department has an existing 68-inch pipeline known as the El Monte Pipeline that will require protection near Magnolia Avenue to facilitate work being constructed by Caltrans.
27	Caltrans Carroll Canyon and I-15 Potable Water	Pipelines	Caltrans is expanding the bridge crossing at Carroll Canyon and I-15, potable water lines on the bridge will need replaced with construction
28	Caltrans Carroll Canyon and I-15 Reclaimed Water	Pipelines	Caltrans is expanding the bridge crossing at Carroll Canyon and I-15, reclaimed water lines on the bridge will need replaced with construction
29	Pomerado Pipeline No. 2	Pipelines	This project provides for negotiating an agreement with the San Diego County Water for the disposition of the City's share of the Pomerado Pipeline.
30	Otay 2nd Pipeline - Isolate Service Sweetwater	Pipelines	Transfer 33 residential services for the Otay 2nd pipeline to the Sweetwater Authority. Project will involve construction of a small pump station to boost pressure from Sweetwater Authority.

**Table A-2**  
**Capital Improvement Plan Project Descriptions**

	<b>CIP Project</b>	<b>Project Type</b>	<b>Description</b>
31	Otay 2nd Pipeline - Cathodic Protect Otay Ranch	Pipelines	17,000 feet of existing pipeline between the South San Diego Reservoir and Olympic Parkway require installation of cathodic protection.
32	Otay 2nd Pipeline - Cast Iron Replacement Phase	Pipelines	This project includes the installation of approximately 1.3 miles of new 42-inch welded steel pipe in 54th Street between El Cajon Blvd and Chollas Station Road which will provide a means to bypass 3.5 miles of the 36-inch cast iron pipeline, located west of 54th Street, abandonment of 1200 feet of existing 36-inch cast iron pipe. This segment includes flow meters, pressure control valves, and connections to the Trojan, Otay I and II and Mid City Pipelines. Also, this project consists of replacement of approximately 3000 feet of existing cast iron pipe in 54th Street with new 16-inch PVC distribution pipelines that will maintain the City's reliable source of potable water.
33	Otay 2nd Pipeline - North Encanto Replacement	Pipelines	The North Encanto Replacement is one of the City of San Diego's most important treated water transmission mains because of its ability to move water between the Alvarado and Otay services, providing great operational flexibility and system reliability. It is also one of the City's oldest pipelines with sections of 36-inch diameter cast iron pipe that are more than 75 years old. The City has received a very good service life out of this pipeline but it is undoubtedly deteriorated due to age and corrosion. To provide the reliability needed in the City's water distribution system, the City has decided to replace approximately 7,000 feet of deteriorated or inaccessible pipe between State Route 94 and the 65th and Herrick Pump Station. The project alignment extends from the intersection of Tooley and 60th Streets, traversing south along 60th Street to Brooklyn Avenue, where it turns eastward and extends along Brooklyn Avenue to Otay Street, turning southeast and extending along Otay Street to the intersection of Herrick and 65th Streets.
34	Lindbergh Field 16in Cast Iron Replacement	Pipelines	This water main must be relocated from underneath the tarmac (landing strip) at Lindbergh Field to a location that is more accessible for operation and maintenance.
35	La Jolla/Pacific Beach - WTR	Pipelines	The installation of approximately 5595 linear feet of 16-inch Water Main Replacement between Camino de la Costa and Tourmaline Street along La Jolla Blvd. This project replaces old and deteriorated 16-inch cast iron mains.
36	Fault Crossing Retrofits to Large Pipelines	Pipelines	There are six large diameter pipelines that cross the Rose Canyon Fault that have been determined vulnerable. It is recommended to retrofit the pipelines using new fault tolerant pipelines and/or install manual isolation valves on either side of the fault. Currently, WD/CIP pursue the pipeline installation of valves and manifolds per FEMA grant for five pipelines (Kearny Mesa, Alvarado 1, Upas Street, Thorn Street, and Laurel Street pipelines).



**Table A-2**  
**Capital Improvement Plan Project Descriptions**

	<b>CIP Project</b>	<b>Project Type</b>	<b>Description</b>
37	Landslide/Liquefaction Pipeline Mitigation	Pipelines	Install 40 pipeline manifold and isolation valve sets at critical backbone pipeline locations that traverse high liquefaction and high landslide zones. Currently, WD/CIP pursue the pipeline installation of valves and manifolds per FEMA grant for nine pipelines (Kearny Mesa, Montgomery-2 sites, Clairemont Mesa, Alvarado 2, Miramar, Miramar Extension, Rancho Bernardo, and Commercial Street pipelines).
38	AA - Water Pump Station Rehabilitations	Pump Station	Many of the pump stations in the water transmission and distribution system have been in service for many years. Some are over 50 years old, and have not been upgraded with more efficient pumps and motors, have worn check and isolation valves and outdated electrical and central systems. This annual allocation CIP project is to upgrade some of these facilities to improve operational efficiency and reliability.
39	Tierrasanta (Via Dominique) Pump Station	Pump Station	Shifting of the water source from the CWA Aqueduct to the Miramar WTP via Pomerado pipeline will reduce suction pressures to this pump station. To compensate for lower suction pressures during summer peaking, the pump station will need to be upgraded.
40	Soledad Pump Station Upgrade	Pump Station	The efficiency, reliability and maintainability of this pump station has diminished over the past 40 years and it is now in need of upgrading.
41	Scripps Miramar Pump Station Upgrade	Pump Station	Rapid growth in the Scripps Miramar Pump Station service area, the lack of adequate redundancy and maintenance needs require immediate upgrade of this pumping station.
42	Tierrasanta Norte Water Pump Station	Pump Station	This project includes the installation of four end-suction centrifugal pumps inside the existing, unused SD #16 flow control facility. The existing building is 18-feet by 17-feet 8-inches by 10-feet 5.5-inches high. The pumps will be one 25 hp (1,200 gpm at 65 feet TDH) and three 50 hp (2,150 gpm at 65 feet TDH) pumps. Roof hatches will be added to the existing building for future installation and removal of the pumps and motors.
43	Rancho Penasquitos Pump Station	Pump Station	Project calls for the design and construction of a new pump station and a new Del Mar pressure reducing station near the site of the existing stations. The new station will house 5 new vertical pumps each rated at 6000gpm and an additional pump can for future expansion. The Del Mar pressure reducing station will be replaced with a new facility.
44	Serra Mesa Pump Station	Pump Station	This project consists of constructing a new water pump station with (5) five 5-mgd pumps. One pump will be a standby. Total pump station capacity will be 20-mgd. The pump plant will pump water from the Alvarado Zone (536) to the Northwest Mesa Zone (currently 559, that will be increased to 600). Emergency power will be provided by portable, engine-generator sets. The pump plant will connect to the existing 36-inch Kearny Mesa Pipeline.

**Table A-2**  
**Capital Improvement Plan Project Descriptions**

	<b>CIP Project</b>	<b>Project Type</b>	<b>Description</b>
45	Parkland Pump Station	Pump Station	This project entails replacing the Paradise Mesa Pump Station No. 1 and No. 2 with a new pump station (located at the Paradise Mesa No. 1 site), improving efficiency and reliability, and allowing for substitution of San Diego City water for San Diego County Water Authority (SDCWA) water now provided via the SDCWA #19 Paradise Mesa Crosstie.
46	AA - Standpipes and Reservoirs	Storage Facility	This project has identified 20 treated water reservoirs for upgrades and demolition.
47	AA - Dams and Reservoirs	Storage Facility	This project includes a broad range of improvements at various dams and raw water reservoirs throughout the system. These include resurfacing access roads, rehabilitation of berms, reservoir aeration systems, installing fencing and security systems, installing lighting around dams, sandblasting and shotcreting dam surfaces, installation of weather stations and water level sensors, rehabilitation or replacement of bridges, ladders and other access systems, installation of remote operators and or/valves, seismic upgrades to specific facilities, plus making other improvements.
48	Barrett Reservoir Outlet Tower Upgrade	Storage Facility	The Barrett Reservoir dam is a concrete gravity structure with a 120-foot high outlet tower with 26 automatic flash gates located on the spillway. The Design Report recommended the following upgrades: replacing piping, valves and bulkheads, replacing the roof, improving ventilation, repairing concrete surfaces and replacing 26 dam spillway gates. Due to WD budget constraint, the project scope of work has been revised to address the essential appurtenances as required by Water Operations Division and Department of Safety of Dams such as replacing piping, valves, replace platform structures and railings, install mechanical ventilation system, electrical and instrumentation system, including dredging.
49	El Capitan Reservoir Rd Improvements	Storage Facility	Upgrade 2.5 miles of access road to the reservoir, starting at the base of the dam and proceeding counterclockwise around the reservoir to the southern tip of the lake. The road will be repaired and portions widened in this project.
50	Morena Reservoir Outlet Tower Upgrade	Storage Facility	The existing Morena Dam is a rock embankment dam with a parapet wall creating a dam 171- feet high above the original stream bed. The outlet tower is 132 feet from the operating floor to the center line of the outlet tunnel. The piping and mechanical system of the outlet tower will be replaced or repaired. The project will include the construction of two sluice gates at the spillway to meet emergency Division of Dam Safety (DODS) drawdown requirements.

**Table A-2  
Capital Improvement Plan Project Descriptions**

	<b>CIP Project</b>	<b>Project Type</b>	<b>Description</b>
51	Rancho Bernardo Reservoir Upgrade	Storage Facility	The project calls for the rehabilitation of the 10-million gallon, trapezoidal-shaped concrete reservoir. Work will include improvements of the beam connection, repairs of the roof slab and columns and a seismic retrofitting to bring the reservoir up to code compliance mandate by Water Department and State Department of Health Service standards.
52	Lower Otay Reservoir - Emergency Outlet Improvement	Storage Facility	The existing Savage Dam creates the Lower Otay Reservoir. At the present time, 56 days are required to achieve a 10% drawdown of the reservoir through the existing 40-inch (48-inch prior to slip lining) outlet pipe. State regulation requires 10% drawdown in a maximum of 10 days. This project will increase the drawdown rate by installing dual 48-inch drain pipes through the existing auxiliary spillway (in addition to existing 40-inch described above). Installation will include two 48-inch butterfly valves and 48-inch flap gates on the spillway bulkheads and intake screens on the upstream end. Length of each pipe will be 70-feet. Maximum existing grade over the pipes is approximately 10-feet above the intended drain pipe invert. This project will also include the seismic retrofit of the outlet tower.
53	Pomerado Park Reservoir Upgrade	Storage Facility	The Pomerado Park Reservoir has a capacity of 5.2 million gallons, and was constructed in 1969. This project includes safety, sanitation, appurtenance, exterior and interior surface restoration, seismic cathodic protection, and structural improvements.
54	Paradise Mesa Standpipe Rehabilitation	Storage Facility	The Paradise Mesa Standpipe was erected in 1979. It is 120-feet tall, with a diameter of 60-feet, and a capacity of 2.5 million gallons. This standpipe services the 610 Pressure Zone. Current seismic standards require that the standpipe be either retrofitted at the foundation to reduce the changes of failure in the event of an earthquake, or reconstructed. A detail analysis between rehabilitation and new installation indicated that two options are very comparable for costs while there are so many benefits in construction of new tank. Some of these benefits are minimal construction restriction and duration constraint, minimal environmental and health risks due to lead-containing primer and coal-tar coating, less operational risks, superior tank with higher life expectancy and less maintenance costs.

**Table A-2**  
**Capital Improvement Plan Project Descriptions**

	<b>CIP Project</b>	<b>Project Type</b>	<b>Description</b>
55	La Jolla View Reservoir	Storage Facility	The La Jolla View Reservoir is a steel tank measuring 70 feet in diameter by 25 feet in height, with a storage capacity of 0.72 million gallons and an overflow elevation of 525. It was built in 1949 to service the pressure system at the time, which was approximately 525 but subsequently increased to 610. The reservoir elevation is too low for the 610 system. This project includes demolition and removal of the old tank, and construction of a new 5.65 million-gallon concrete reservoir at an overflow elevation of approximately 570 feet. The tank will be constructed underground with a small deck above the ground access building.
56	La Jolla Exchange Place Reservoir	Storage Facility	The La Jolla Exchange Place Reservoir is a covered concrete reservoir with a storage capacity of 1.0 million gallons and an overflow elevation of 273. It was constructed in 1909 to operate in the 270 zone. It currently serves only as a forebay to the onsite Exchange Place Pump Station which pumps from 267 to 610. It is rarely used except to maintain the water quality within the reservoir. This project includes demolition of both the La Jolla Exchange Place Reservoir and Exchange Place Pump Station. The 1.0 million gallons of emergency storage will be consolidated into a new La Jolla View Reservoir at a higher location within the 610 zone, eliminating the need for pumping.
57	La Jolla Country Club Reservoir Seismic Upgrade	Storage Facility	This project will be necessary to perform a seismic study to make sure the reservoir meets current seismic standards.
58	Murray Outlet Tower	Storage Facility	Retrofit from interior. A planning study should analyze the outlet tower's current capacity and its ability to provide flow to Alvarado Treatment Plant if the CWA Aqueduct and El Monte Pipeline fail in a seismic event.
59	San Carlos Reservoir Interior Enhancement	Storage Facility	The San Carlos Reservoir Interior Enhancements Project will install a synthetic membrane lining system to prevent leakage from the 5.0 MG prestressed wire-wrapped concrete circular potable water tank located at the intersection of Wing Span Drive and Tommy Drive in the San Carlos community. The reservoir, originally built in 1965, was substantially rehabilitated in 2001. That work included a seismic retrofit plus valve, pipeline, and appurtenance upgrades to bring the facility up to code. This is the final step in the complete rehabilitation process.

**Table A-2**  
**Capital Improvement Plan Project Descriptions**

	<b>CIP Project</b>	<b>Project Type</b>	<b>Description</b>
60	Lake Hodges Dam Modification	Storage Facility	Construction of a parapet wall on top of the Hodges dam. The geotechnical study of the dam foundation determined that dam overtopping flows could potentially erode the left abutment of the dam during a Probable Maximum Flood event and compromise the stability of the dam. The parapet wall will protect the dam and mitigate the possible overtopping.
61	Morena Dam Grotto	Storage Facility	The grotto was formed before the Morena Dam was constructed, however the presence of the grotto was not known to the City Operations staff until 1992 when the members of the San Diego Grotto, National Speleological Society (grotto society) discovered the grotto. The DSOD has shown concern for the affect the grotto has on dam stability.
62	AA - Pooled Contingencies - RWDS	Reclaimed Water	This CIP item provides contingency funds for expenditures incurred that are greater than the contracted amounts to install service connections of the reclaimed water distribution system to consumers.
63	AA - Reclaimed Water Extension	Reclaimed Water	Extensions of the North City reclaimed water distribution pipeline network beyond the sphere of influence of the existing North City Reclaimed Water distribution pipelines and improving the reclaimed water distribution system as the demands for reclaimed water increase.
64	Black Mountain Ranch Reclaimed Water Storage Tank	Reclaimed Water	The reservoir is a circular, above grade, metallic tank with a capacity of 3 MGD to storage recycled water. The design cost is \$384,106 with an estimated total project cost of 4.7 million. Construction of the tank began in January of 2005 and it was com
65	Carmel Valley Reclaimed Water Pipeline	Reclaimed Water	This project is designed to expand the reclaimed water system into the North county. This project will install approximately 9000 LF of 12" and 8" plastic pipe. It will provide future service to the Del Mar National Golf Course and the Pacio HOA.
66	Los Penasquitos Canyon RWP Part Agmt	Reclaimed Water	Part of the North City Reclamation System. The project will facilitates moving recycled water from the North City Water Reclamation Plant to service areas in the northern region of the City of San Diego. The 9000 LF - 24" pipeline project will begin by connecting to the suction line of the Canyonside pump station, goes through the Canyonside Parkland, along Park Village Road and Camino Del Sur.
67	Pacific Highlands RWP - Participation Agreement	Reclaimed Water	This project proposes to construct 11,770 linear feet of new 12-inch and 16-inch diameter PVC pipe, beginning East of Santa Fe Farms Road moving westerly along Carmel Valley Rd to the intersection of SR 56.

**Table A-2  
Capital Improvement Plan Project Descriptions**

	<b>CIP Project</b>	<b>Project Type</b>	<b>Description</b>
68	Camino Del Sur RWP - E&CP	Reclaimed Water	This proposed recycled water pipeline is part of the Camino Del Sur Road extension project. This pipeline includes the construction of approximately 3,300 linear feet of 24-inch diameter steel recycled water pipeline to be constructed concurrently with the road extension. This will provide a vital connection to serve recycled water to the Rhodes Crossing Development, Torrey Highlands (Subarea IV), Fairbanks Highlands, Pacific Highlands, Carmel Valley and future customers in the 500 Zone. This proposed project is an integral part of the City's reclaimed distribution network since it is the piece needed to charge the system to serve SR-56 and customers in Pacific Highlands.
69	Camino del Sur Recycled Water P/L- Participation Agreement	Reclaimed Water	The Camino Del Sur RWP (Participation Agreement) is located in the Rancho Penasquitos /Torrey Highlands area of the City of San Diego. A portion of which lies within the North City Planned Urbanizing Area (NCPUA) Subarea IV and along the State Route 56 as it crosses the southern extensions of Carmel Mountain Road and Camino del Sur within Subarea IV. The proposed project is a 24-inch recycled water transmission main on Camino del Sur. The City will enter into a participation agreement with the developer to construct the pipeline concurrently with the construction of Camino del Sur
70	Mission Valley Groundwater Desalination	Groundwater	This concept project proposes to extract and desalinate 2,000 AFY from the western portion of the basin for potable use. Two extraction wells, with an average yield of 1,000 gpm, would be necessary. Approximately 1,700 AFY (1.5 mgd) of desalinated water and 300 AFY (0.27 mgd) of brine would be produced.
71	San Pasqual Brackish Groundwater Desalination Demo	Groundwater	This project component entails extracting 5,800 AFY of groundwater from the western portion of the basin and desalinating it by means of a RO water treatment plant. The water supply produced will be approximately 5,000 AFY.
72	San Pasqual Brackish GRD Demo	Groundwater	The project entails extracting and desalinating groundwater, resulting in the production of 250 AFY of desalinated water.
73	San Diego Formation Desalination	Groundwater	Based on available information, it is recommended that the City consider the implementation of a two-phased project. The first phase will consist of the extraction of 3,300 AFY of brackish groundwater, to produce 2,800 AFY (2.5 MGD) of desalinated water. Based on the results of additional investigations and on observations of the aquifer during the operation of the first phase, the City could consider the implementation of a second phase, for a total capacity of 5.0 MGD.

**Table A-2  
Capital Improvement Plan Project Descriptions**

	<b>CIP Project</b>	<b>Project Type</b>	<b>Description</b>
74	Groundwater Pilot Production Wells	Groundwater	Construct a pilot production well at up to four sites, perform Aquifer tests and hydrogeological analyses of basins in which wells are installed to determine feasibility of further development, conduct environmental studies, water quality assessments and economic feasibility analysis.
75	SD 17 Flow Control Facility (Alvarado)	Security	This project is the construction of a pump plant to feed the Mid-City Pipeline from the Alvarado Water Treatment Plant. This pump plant and the Mid-City Pipeline provide required redundancy for, and relieve the capacity load on, the existing Trojan Pipeline, which is the "backbone" transmission facility of the Alvarado water supply system. To avoid the high cost of crossing Interstate 8 (I-8), the pump plant discharge pipe will be connected to the San Diego County Water Authority's (SDCWA's) Pipeline 4B at a location north of I-8. Water is taken out of Pipeline 4B south of I-8 at the Mid-City Pipeline connection. The pump plant will have a total capacity of 93 cubic feet per second (cfs). Approximately 200 feet of 72-inch diameter steel pipe will be installed to transmit water from the Alvarado Water Treatment Plant into the SDCWA's Pipeline 4B. This project will also include a Flow Control Facility to allow the City to draw water from Pipeline 4B.
76	Water Dept. Security Upgrades	Security	This CIP project was created in compliance with the Vulnerability Assessment Report (VA), dated December 31, 2002. Thus, it will design and install miscellaneous security systems at various facilities to improve security, control entry and reduce opportunities for intrusion of unauthorized persons. The VA recommended \$20,430,000 in upgrades on existing water facilities. Individual sub-projects may be created, as required.
77	Water Dept. Security Upgrades - Miramar	Security	This CIP project was created in compliance with the Vulnerability Assessment Report (VA), dated December 31, 2002. Thus, it will design and install security systems at various Regulators to improve security, control entry and reduce opportunities for intr.
78	AA - Corrosion Control	Miscellaneous	This Annual Allocation will fund the installation of corrosion protection (such as "anode beds" and "deep well anodes") to extend the service life of existing facilities. Individual sub-projects will be created as required.
79	AA - Pooled Contingencies - Water	Miscellaneous	This CIP item provides for contingency costs, as required, for all water projects that are greater than the contracted amounts.

**Table A-2**  
**Capital Improvement Plan Project Descriptions**

	<b>CIP Project</b>	<b>Project Type</b>	<b>Description</b>
80	AA - Meter Boxes	Miscellaneous	Annual Allocation for Replacement of Meter Boxes as needed.
81	AA-Pressure Reducing Stations	Miscellaneous	This annual allocation will install new pressure reduction facilities, and replace of upgrade existing pressure reduction facilities to meet present and future water demands. Individual sub-projects will be created as required.
82	Miramar Service Area Improvements	Miscellaneous	Unidentified projects that require funding per master planning study.
83	Alvarado Service Area Improvements	Miscellaneous	Unidentified projects that require funding per master planning study.
84	Otay Service Area Improvements	Miscellaneous	Unidentified projects that require funding per master planning study.
85	Kensington Pressure Regulator	Miscellaneous	The completion of Mid City Pipeline Project and it operation at the design pressure level will enable to increase the pressure throughout the Normal Heights areas. The Kensington Park Villas community is located at the lowest elevation within Normal Heights; this pressure increase will result in over pressurizing of the Community's water distribution system. The pressure Regulating Stations (PRS) provides more consistent water pressure throughout the Community and would serve to avoid pipe ruptures or other problems due to over pressurizing.
86	Alvarado Water Quality Lab Roof Replacement	Miscellaneous	This project replaces the roof on the water Quality Lab located at the Alvarado Water Treatment Plant.
87	Barrett Flume Cover	Miscellaneous	Each year, golden eagles, deer and other wildlife drown in the open channel section of the Barrett Flume. This 10 - 12 mile open channel section is also causing an excessive maintenance burden to keep out soil, sediment and sunlight-caused algae build-up. Covering of the open flume sections is necessary to preempt fines and sanction from the resource agencies, to maintain water quality, and to reduce maintenance and down time.



Appendix B  
CIP Construction Cost Estimates  
City of San Diego SOP

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## **1.0 PURPOSE:**

This Standard Operating Procedure (SOP) provides the following general guidelines in the preparation of reliable construction cost estimates of Capital Improvement Projects (CIP):

- Preparation of the Engineer's Estimate and associated construction costs
- Types of construction cost estimates
- Construction cost estimating approaches
- Available cost estimating resources
- Ranges of construction administration & contingency costs
- Cost estimate submittals & expected accuracies at various stages of design
- The roles & responsibilities of the participants in the cost estimating process

## **2.0 SCOPE:**

This SOP provides the information and approaches for the preparation of CIP construction cost estimates and related administration costs. Project Managers (PM) should determine the best construction cost estimating approach and level of effort suitable for the specific CIP project.

This SOP focuses on the construction cost estimation of in-house designed CIP projects rather than those prepared by design consultants. This SOP specifically covers the construction administration and contingency cost estimates associated with both in-house and consultant designed projects.

## **3.0 BACKGROUND:**

An accurate construction cost estimate is essential to successful project management and a requirement for the service provider's and client's sound fiscal budgeting. Large variances between the engineering estimate and actual contractors' construction bids can delay the award of projects and creates additional activities (e.g. 1472, re-advertise, reduction in scope, etc) that the PM must perform to ensure the successful construction-award of the project.

## **4.0 RESPONSIBILITY:**

The PM is ultimately responsible for the construction cost estimate's completeness and accuracy. It is also the PM's responsibility to ensure this SOP is adhered to and that the Section Head reviews the estimates. The Project Engineer (PE) applies this SOP during the preparation of project cost estimates to maintain uniformity in the development of the estimates and to facilitate review by various project participants.

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## 5.0 PROCEDURE:

**CIP Cost Categories** - At a high level, a CIP's cost is made up of design and construction costs, each of which include contractual and City labor charges. City labor charges are incurred as part of design, administration, and processing activities. Table 1 below lists the high level elements that make up a project's costs. The SOP addressing Total Project Cost Estimation will address Design (item A). Administration and Engineering is estimated and accounted for under the Design Cost Estimate. Administration and Engineering includes the preparation of the construction drawings (specifications and plans) as well as the project management/design staff's administration of the project as a whole, from start of design until project close-out.

This SOP addresses the Construction Cost Estimate element (Table 1, item B), and all sub-elements (e.g. Engineer's Estimate, Contingencies, and Field Engineering). The Engineer's Estimate is the Project Engineer's estimate of the Construction Contract that will be bid and awarded for construction.

Of the elements listed in Table 1, item B1a (Bid Item Quantities) is one of the most complex estimating methodologies presented in this SOP.

<b>Table 1 - Cost Categories (Elements of a CIP's Total Budget/Costs)</b>		
<b>A - Project Design Costs</b>	20% to 40%	Of Total Budget *
1 - Administration		
2 - Engineering		
<b>B - Project Construction Costs</b>	60% to 80%	Of Total Budget *
1 - Engineer's Est (Constr Contract)	30% to 60%	Of Total Budget *
a - Bid Item Quantities		
b - Mobilization	5% to 10% (1)	Of Construction
c - Traffic Control	5% to 10% (2,3)	Of Construction
d - Water Pollution Control	2% to 5% (1)	Of Construction
e - Bonds	2.5% (4)	Of Construction
f - Field Orders	2.5% to 10% (3)	Of Construction
2 - Contingencies	10% to 15%	Of Construction
3 - Constr Admin - Field Engineering	10% to 15%	Of Construction
* Total Project Budget (costs) = (Design Costs) + (Construction Costs)		
(1) Depending on location		
(2) Depending on ADT		
(3) Depending on project complexity		
(4) Per specification		

The range in percentage values listed in Table 1 reflect the varying complexities of a project as well as the varying site conditions that may be encountered (e.g. roadway vs. building, pipeline

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vs. bike path). It is not in the scope of this SOP to provide values for each of the asset and project types encountered, but instead to provide a guideline for achieving the standard industry values.

Note that construction “**contingencies**” (item B2 in Table 1, page 2) is an amount other than the Engineer's Estimate (construction contract cost) that is set aside as a reserve for unforeseen construction conditions. The Engineer's Estimate does not contain the contingency amount. This amount is applied to in-scope activities only and not to be used for out of scope items or activities.

**Cost Estimate at 10% (Conceptual) Design (Planning Package):** The operating division or asset planning group prepares this cost estimate once the project is identified and resources for implementing the project are being determined. This cost estimate accompanies the preliminary engineering package and is considered a rough estimate that requires field and technical validation by the assigned PM.

**Cost Estimate at 30% (Preliminary) Design:** This cost estimate is developed once the Project Manager receives the planning (pre-design) package (10% Design) from the client department or the Preliminary Engineering Section. This estimate is the first construction budget developed from project specific design criteria. This estimate is submitted with the 30% design. The framework of this estimate is based on quantities and unit price models developed from the design criteria, site layout, soils reports and the completed 30% Design Plans. This cost estimate has an expected accuracy of +30% to -15% of the actual cost of construction.

**Cost Estimate at 75% Design:** This cost estimate is an extension of the Cost Estimate at 30% Design. It is the interim budget cost estimate developed to conform to the latest project-specific design criteria. This estimate is submitted with the 75% design. The framework of this estimate is based on quantities and unit price models further refined by field investigation or revised assumptions from the design criteria, site layout, soils reports and the completed 30% Design. This estimate includes unit prices associated with environmental review, mitigation requirements, and discretionary permits. This cost estimate has an expected accuracy of +20% to -10% of the actual cost of construction.

**Cost Estimate at 90% Design:** This cost estimate is an extension of the Cost Estimate at 75% Design. This is a semi-final cost estimate which is sent to Field Engineering Division along with 90% design plans for Constructability Review. This is the most detailed estimate of all the previous estimates, where the project scope is close to being completely defined. Given that this project is close to design completion and near-ready to advertise and award, cost figures should reflect the most recent bidding updates. This construction cost estimate has an expected accuracy of +10% to -10% of the actual cost of construction.

**Cost Estimate at 100% (Final) Design:** This cost estimate is referred to as the “Final Engineer's Estimate”. This estimate is prepared once all plan check comments have been

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incorporated into plans and Constructability Review is completed. The estimate is intended to serve as the final project cost plan, a comparison to the interim budget level cost estimate, and the Analysis of Construction Bids.

**Cost Estimation Approaches and Methods** - There are two approaches to cost estimating, under each of which there are several methods (techniques) available:

#### **Cost Estimating Approaches**

- **Top Down** - Relates to total costs, or costs of major elements, of similar projects. Under this approach, the estimate begins with a total figure and is then broken down into smaller parts, progressively detailing the estimate until all project elements are accounted for. The PM/PE should be cautious when using this approach since certain project details may be overlooked and would result in an undervalued total project cost. The Top Down approach utilizes a **Work Breakdown Structure (WBS)** method. This involves stating the work at a high level (top-down) and then breaking the work (e.g. products or tasks) into smaller components called activities. Each of the WBS activities identifies the associated dollar (labor and material) and scheduling (duration, start and end times) details. Other additional costs, not included in these items, are allocated as a percentage of the total cost components. These components appear as separate line items in the cost estimate summary as follows: Field Engineering, Bonds, Mobilization, Traffic Control, and Water Pollution Control. While this approach requires more effort than other methods, if the PE understands the work well and ensures that the required work is included in the work breakdown structure, an accurate estimate may be achieved.
- **Bottom Up** - Breaks the product into smaller elements and estimates each individually. The individual elements are then grouped back together to come up with an overall cost estimate. The PM/PE should use caution when using this approach because the risk associated with this approach is in being overly conservative on each of the individual elements to where the total cost estimate is inflated.

#### **Cost Estimating Methods**

- **Ratio** - Applies *fixed ratios* to costs of major elements based on previous similar projects. While all projects are considered to be unique, some projects are similar in scope to others. Using the Ratio cost estimating method, the PE looks for similar projects previously (and most recently) completed and then estimates work based on the actual cost required for the completed project. This is a reliable method for estimating work since it utilizes actual historical data; however, the projects must be similar in scope and the completed project must have detailed and accurate accounting.
- **Parametric** - This approach follows, in principle, that of the Ratio Method but instead of a fixed ratio, the Parametric Method uses a more complex correlation of smaller element costs to larger ones (e.g. based on size, quantity, complexity, technique, etc...).
- **Standards** - Estimates every project element using published or in-house standard cost for that element. Standard estimates may be ratio-based or parametric, but the data used is a compilation and the source of the projects is unknown.

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**Construction Cost Estimate Submittals & Updates** - Construction Cost Estimates are prepared at each stage of design (identified in Table 2). Additionally, in between any of the above stages of design, construction cost estimates are updated at a minimum of every 6 months, or when there is a change or new information on the project or the project is being re-initiated (removed from the shelf). These changes/ new information include:

- change in scope (reduction or additions)
- change in site conditions (recent construction activity or discovered utilities)
- recent spike or dip in material prices
- change in construction phasing

Anytime a project is shelved for more than 6 months, cost figures should be updated to match the latest unit price data. Where projects have been shelved for more than 1 year, a site visit and a redefinition of all the project scope elements is necessary to reflect changes in existing field conditions.

Table 2 - Design Submittals			
Design Stage	Type of Submittal	Expected Accuracy	Submitted To
10%	Conceptual		Stakeholders/ Project Manager
30%	Preliminary	+30% to -15%	Stakeholders/ Client/ Permit Applications
75%	Intermediary	+20% to -10%	Client
90%	Substantial	+10% to -10%	Citywide
100%	Final	+10% to -10%	Advertise

The PE provides the following types of construction cost estimates (in current dollars) to the Project Manager for review and comments during design (see Table 2).

Each cost estimate is titled to correspond with the design completion stage and the type of estimate. The cost estimate includes an assessment of the difficulties inherent in the construction work and documents the price determinations and the assumptions for preparing the cost estimates. This may include factors such as labor conditions, construction equipment, construction supervision, material costs, and equipment installation costs. All reasonable costs a Construction Contractor can expect to incur are also included.

The construction cost estimate includes the line items listed in Table 1.

Following completion of the 90% Design, the PE participates in cost estimate review meetings with the PM and QA/QC Group to reconcile cost estimates and discuss each party's respective cost estimate.

**Construction Cost Estimation Accuracies** - The accuracy of the estimate is dependent upon what is known, what is assumed, and what is unforeseen at the time the estimate is prepared.

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Furthermore, it should be noted that, while the Engineer's Estimate attempts to forecast the cost of the proposed work, the estimate may not always closely correlate to the low bid. Variances are expected because of the nature of Public Works contracting. Items that contribute to these variances include:

- Errors by contractors in preparing bids (i.e. both quantity takeoff & pricing errors).
- Competitive nature of bidding as a result of market conditions, number of contractors submitting bids, importance of the project to a particular contract or contractors.
- The level of refinement of the scope of the project and/or the project construction documents. (i.e., completeness and accuracy of the drawings and subsequent interpretation of the drawings by the bidders).
- Significant fluctuations in the cost of materials, labor, and equipment.
- Recent experience with similar projects.
- The complexity of the project, type of construction, and age of existing facilities.

**City Forces Work** - All City furnished equipment or materials and all labor costs (e.g. those associated with Water Department system shutdowns, connections, and water service highlining) are excluded from the construction cost estimates submitted by the PE unless otherwise required by the Project Manager. Installation costs for these items incurred by the Construction Contractor are included in the cost estimate. Note that non-contractor expenditures that would be incurred as part of constructing the project (e.g. environmental mitigation) should be identified and noted in the overall project budget.

**Special Benefits and Maintenance Costs** - The costs associated with special benefits and long term maintenance (irrigation, landscaping, non-standard elements such as streetlights, color concretes, etc), are not included in the construction cost estimate. However, the PM is responsible for ensuring that the funds are available for these activities (i.e. Maintenance Assessment District, Service Level Agreement, etc.).

**Cost Estimates for Projects Receiving Federal and State Grants** - For projects funded with Federal/State monies, the PM must take into account increases per unit item for costs associated with increased wage rates (prevailing wages) that the contractors are required to pay their employees.

**Cost Estimating Spreadsheets** - While the use of computerized cost estimating software is preferred if available, spreadsheets are considered equally dependable tools for generating cost estimates provided they have the most recent unit prices and most accurate quantities inputted. Spreadsheets must clearly label the item, quantity, and unit price applied and the construction item must be clearly identified on the associated construction plans and construction specifications' bid list.

**Cost Estimates Documentation** - The PE maintains a file documenting justification for the cost estimations prepared at all stages of design. The documentation file includes, at a minimum,

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the sources, methods, quantities, and prices used in developing the cost estimates (as applicable) such as:

- A reference of the source of unit prices used
- Quotations with estimated installation costs
- Completed project title(s) & CIP number(s) used for cost comparisons
- Details, sections, and sketches used to perform typical quantity takeoffs

## **6.0 DEFINITIONS:**

**Bid:** The offer or proposal of the Bidder submitted on the prescribed form setting forth the prices for the Work.

**Bond:** Bid, performance, and payment bond or other instrument of security.

**Consultant:** One who provides a specialized service based on their special qualifications, education, or experience.

**Contingency:** An amount other than the Engineer's Estimate that is set aside as a reserve for unforeseen construction conditions – this amount is to be used on in-scope items only and not to be used for scope creep items.

**Engineer's Estimate:** The projected cost of construction based on completed design and detailed cost estimates.

**Mobilization:** Process of activating resources including labor, equipment, and supplies. The process includes setup at or near location of work to attain full or partial readiness to commence construction activities.

**PE (Project Engineer):** Assistant to the PM responsible for close oversight of project design details.

**PM (Project Manager):** Ultimate responsible individual for the management of all project resources and project overall quality.

**Prevailing Wages:** Higher wages imposed on federal and state funded projects.

**Shelved Project:** A project where no active processing or review has been conducted.

**SWPPP:** Storm Water Pollution Prevention Plan for permit compliance during construction activities.

**Unit Price:** The amount stated for a single unit of an item of work.



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**WBS (Work Breakdown Structure):** The list of tasks and subtasks defined for a project. This list is done in a hierarchical fashion, grouping sets of related tasks under a common parent task.

**7.0 REFERENCES and/or RELATED DOCUMENTS:**

**8.0 ATTACHMENTS:**

**9.0 P3 ACTIVITIES:**

## APPENDIX C

### INFORMATION CONCERNING THE SAN DIEGO COUNTY WATER AUTHORITY AND METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

*The following information concerning the San Diego County Water Authority (the "CWA") and the Metropolitan Water District of Southern California (the "MWD") has been excerpted from publicly available sources, which the City believes to be accurate, or otherwise obtained from the CWA and the MWD. The CWA and the MWD are not obligated in any manner for payment of debt service on the Series 2009A Bonds, and they did not review and will not provide any certifications regarding this Appendix. The City of San Diego (the "City"), the Public Facilities Financing Authority of the City of San Diego (the "Authority"), the San Diego Facilities and Equipment Leasing Corporation (the "Corporation") and the Underwriters take no responsibility for the completeness or accuracy thereof.*

#### San Diego County Water Authority

Organization and Authorization. CWA was organized on June 9, 1944, under the County Water Authority Act for the primary purpose of providing a supply of imported water to its member agencies for domestic, municipal, and agricultural uses. CWA has 24 member agencies, consisting of the City, the Carlsbad Metropolitan Water District, the City of Del Mar, the City of Escondido, the Fallbrook Public Utility District, the Helix Water District, the Lakeside Water District, the City of National, the City of Oceanside, the Olivenhain Metropolitan Water District, the Otay Water District, the Padre Dam Metropolitan Water District, the Camp Pendleton Marine Corps Base, the City of Poway, the Rainbow Metropolitan Water District, the Ramona Metropolitan Water District, the Rincon del Diablo Metropolitan Water District, the San Dieguito Water District, the Santa Fe Irrigation District, the South Bay Irrigation District, the Vallecitos Water District, the Valley Center Metropolitan Water District, the Vista Irrigation District and the Yuima Metropolitan Water District. CWA obtains water from MWD, which derives its supply from the Colorado River and the State of California Water Project, and also from the IID, which derives its supply from the Colorado River. CWA delivers water to its member agencies through five large-diameter pipelines located in two right-of-way corridors known as the First and Second San Diego Aqueducts.

The decision-making body of CWA is its 35-member Board of Directors (the "CWA Board"). Each of the member agencies of CWA has at least one representative on the CWA Board. Any member agency may appoint one additional representative for each full 5% of total assessed value of property taxable for CWA purposes that is within the public agency's boundaries. As a result, the City is entitled to representation by 10 directors, the Helix Water District is entitled to representation by two directors and the Otay Water District is entitled to representation by two directors. Under the County Water Authority Act, California Statutes 1943, Chapter 545, as amended (the "CWA Act"), a member agency's vote is based on its "total financial contribution" to CWA since CWA was organized in 1944. Total financial contribution includes all amounts paid in taxes, assessments, fees and charges to or on behalf of CWA or MWD. The CWA Act authorizes each Board member to cast one vote for each \$5,000,000, or major fractional part thereof, of the total financial contribution paid by the member agency. Based on the foregoing formula, as of January 1, 2008, the City is entitled to 618.826 of the aggregate 1,431.208 votes, which accounts for 40.42% of all votes. The member agency with the next highest number of voting entitlements, for comparison purposes, is the Helix Water District, which has 111.732 votes or 7.30% of the aggregate votes. The City of San Diego has adopted an ordinance pursuant to which its directors vote as a block, as determined by a majority of the City's representatives. Another provision of the CWA Act states that, except as otherwise provided in the CWA Act, a 55% vote is required for CWA Board action. Whenever the City proportion of financial contribution equals 38% or less, however, all CWA Board actions will be required to receive only a majority of the vote.

Over the last five fiscal years, the City has purchased an average of 90% of its water from CWA, with the remainder from local surface and groundwater sources and the use of reclaimed water for irrigation. The City projects that with increases in the sale of reclaimed water and consistent use of local surface water, city purchases of water from the CWA could drop to approximately 83% in Fiscal Year ended June 30, 2015. In calendar year 2007, approximately 230,000 AF of water from CWA was delivered to customers in the City. The City estimates that a seven percent increase in the demand for water from the CWA will occur between calendar year 2007 and 2020. The City attributes the increase to a projected 14% increase in the City's population.

As of Fiscal Year ended June 30, 2007, CWA member agencies' combined imported and local water use totaled 741,893 AF. Of the 222,496 AF sold to the City by CWA in Fiscal Year 2006-07, 632 AF was for agricultural use and 221,864 AF was for non-agricultural consumptive use. Table C-1 below sets forth the City's local water production and CWA supplied water for Fiscal Years ended June 30, 2003 through 2007.

**TABLE C-1**  
**CWA WATER SUPPLIES TO THE CITY OF SAN DIEGO<sup>(1)</sup>**  
**Fiscal Year 2003 through 2007**  
**(In AF)**

<b>Fiscal Year</b>	<b>Local Production<sup>(2)</sup></b>	<b>CWA Water Supplies<sup>(3)</sup></b>	<b>Total</b>
2002-03	22,914	192,641	215,555
2003-04	11,119	227,220	238,339
2004-05	22,866	204,039	226,906
2005-06	35,959	196,940	232,898
2006-07	17,770	222,496	240,266

Source: San Diego County Water Authority.

<sup>(1)</sup> Excludes local surface water use by the City outside of CWA service area.

<sup>(2)</sup> Includes surface, recycled and groundwater supplies; does not reflect conserved water.

<sup>(3)</sup> Water use in a given year may differ from CWA sales due to storage.

CWA water rates are established by the CWA Board and are not subject to regulation by the California Public Utilities Commission or by any other local, state or federal agency. Effective January 1, 2003, the CWA's Board implemented a rate structure that included fixed storage and customer service charges, and variable transportation, melded municipal and industrial ("M&I") treatment and melded M&I supply rates. Agricultural customers pay the transportation rate and the customer service charge while M&I customers pay the transportation rate, the customer service charge, and the storage charge, which funds CWA's emergency storage project. Agricultural water users have elected to receive a reduced level of service during an emergency, in return for excluding the cost of the Emergency Storage Project from their water rate, and pay MWD's Interim Agricultural Water Program rate instead of the CWA's melded supply rate. The customer service and storage charges are fixed charges that enable the CWA to increase its coverage of fixed expenditures by fixed revenues. Water rates are set on a calendar year basis. Other Water Authority rates and charges include the Infrastructure Access Charge ("IAC"), the Water Standby Availability Charge, the System Capacity Charge and the Treatment Capacity Charge. Certain of these charges are passed through to the City's customers.

The City Council of the City (the "City Council") approved service rate increases of 6.5% in Fiscal Year 2009-10 and 2010-2011. Based on City policy, the approved rates are updated semi-annually by the City Council with pass-through surcharges to reflect minor adjustments for actual versus projected

water purchase costs imposed on the City by CWA. The Water Department's calculation of increased rates in future Fiscal Years is based on, among other things, the CWA increase in the cost of water and the cost of its planned Indirect Potable Reuse and Reservoir Augmentation Demonstration Project. Unlike unit water rates for other customer classifications, the rates paid by interruptible agriculture customers are a function of MWD and CWA rate schedule policies, and are not projected to change in any material aspect.

CWA Water Supply. CWA imports most of its water from MWD and smaller portions from the San Diego County Water Authority/Imperial Irrigation District Conserved Water Transfer Agreement and the Coachella Canal Lining Project. MWD obtains its water supply from two primary sources: the Colorado River via the Colorado River Aqueduct and the SWP via the Edmund G. Brown California Aqueduct. See "THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA" herein. Water that the CWA receives from the IID is also derived from the Colorado River and is conveyed through the Colorado River Aqueduct pursuant to an exchange agreement with MWD. Recently, the CWA has received approximately 50-65% of its imported water supply from the Colorado River and the remaining 35-50% from the SWP. The CWA began receiving transfer water from IID in December 2003. Starting with the initial delivery of 10,000 AF, the amount of water to be delivered is increasing according to an agreed-upon schedule until the maximum transfer yield of 200,000 AFY is achieved. In addition, the CWA will receive approximately 80,200 AF of imported water per year from the All-American Canal Lining Project and the Coachella Canal Lining Project. See "Quantification Settlement Agreement" herein. The CWA began receiving water from the Coachella Canal Lining Project in January 2007. Water from the All-American Canal Lining Project will be available on a reach-by-reach basis as each reach of the relining project is completed. San Diego Creek Reach 2 and San Diego Creek Reach 3 were completed this year and San Diego Creek Reach 1 is expected to be completed in Spring 2010.

The CWA is a member agency of MWD, which was created in 1928 by vote of the electorates of eleven Southern California cities, to provide a supplemental supply of wholesale water for domestic and municipal uses to its constituent agencies. The MWD service area comprises approximately 5,200 square miles and includes portions of the six counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego and Ventura. There are 26 member agencies of MWD, consisting of 14 cities, 11 municipal water districts and the CWA. A Board of Directors (the "MWD Board"), currently numbering 37 members, governs MWD. Each constituent agency has at least one representative on the MWD Board. Representation and voting rights are based upon the assessed valuation of property within each constituent agency. The CWA has four members on the MWD Board. The CWA is the largest purchaser of water from MWD. In the Fiscal Year ended June 30, 2007, the CWA's estimated water purchases from MWD represented approximately 26% of MWD's total deliveries.

In the Fiscal Year ended June 30, 2007, MWD supplied approximately 2.24 million AF of water to its member agencies. During years of normal precipitation, existing water supplies of MWD are sufficient to meet demands within the service area of MWD. In the future, several variables could impact to some extent the availability of both existing and future supplies in normal years. Supply deficiencies can occur during periods of drought. Increased demand on MWD water due to population growth, coupled with a reduction of MWD's existing water supplies could reduce the amount of water available to MWD to supply the CWA, which could affect the supply of water to the City. The Metropolitan Water District Act, California Statutes 1969, Chapter 209, as amended (the "MWD Act") provides a preferential entitlement for the purchase of water by each of the MWD constituent agencies. This preferential right is based upon a ratio of all payments made to MWD by each constituent agency on tax assessments and other payments toward the capital cost and operating expense of MWD, except purchases of water, to all such payments made by all constituent agencies. Based upon the formula as applied by MWD, as of June 30, 2007, the CWA has a statutory preferential right to 16.73% of MWD's total supply. It is MWD's declared policy to meet all the supplemental needs of each of its member agencies, including the CWA. However, MWD's Board adopted a shortage allocation method in February 2008 (the "Water Supply

Allocation Plan"). See "METROPOLITAN WATER DISTRICT SUPPLY MANAGEMENT STRATEGIES" herein. The method allows MWD, in the event of shortages, to allocate water based on uniform reduction by class of water service, with adjustments made for growth, loss of local supply, demand hardening due to implementation of water conservation, and the amount of a member agency's dependence on MWD for its total water supply, as well as other water supply related factors. Any extended curtailment could be accompanied by an increase in MWD water charges to its member agencies including, among others, the CWA, and consequently could necessitate an increase in water rates to the member agencies of the CWA including, among others, the City. The City has taken into account the effect of the drought on operations in its Fiscal Year 2008-09 and Fiscal Year 2009-10 budgets by assuming a 15% reduction in water sales and deliveries, which is expected to result in reduced revenues which are offset by reductions in both its operating budget and its capital improvement budget. See "WATER SYSTEM CAPITAL IMPROVEMENT PROGRAM" and "WATER SYSTEM FINANCIAL OPERATIONS – Operation and Maintenance Expenses" in the forepart of this Official Statement.

CWA Current Water Supply Outlook. CWA's water supply portfolio is comprised of seven programs: MWD water supplies, San Francisco Bay/Sacramento-San Joaquin Delta Estuary ("Bay-Delta") water supplies, Colorado River water supplies, reclaimed water, water conservation, local surface water and groundwater. The primary sources from which the CWA receives its water supplies are being impacted by adverse supply conditions as a result of recent multiple dry year events and judicial delivery constraints. The Colorado River basin, which on average provides over 60% of the CWA's supply, has experienced significant drought events over the last several years resulting in diminished reservoir storage levels along the river. Locally, conditions within the County watershed are below normal as well, with the region in the midst of its third consecutive year of below normal rainfall. As a result of these conditions and certain SWP environmental issues described herein, the CWA faces near-term supply challenges.

In late 2007, MWD notified its member agencies that it expected considerable supply challenges for the forthcoming 2008 water year (October 2007 – September 2008), which would result in insufficient core supplies from the Colorado River and SWP to meet demand. As a result, MWD announced that it would cease replenishment deliveries and implement a 30% cutback in agricultural deliveries to customers participating in the MWD sponsored Interim Agricultural Water Program ("IAWP"). On November 28, 2007 the CWA Board adopted a Regional IAWP Reduction Plan which outlined an array of potential actions available to local farmers to ensure compliance with the 30% IAWP cutback starting January 1, 2008. In addition to the IAWP reduction, MWD also announced that it would need to draw from its Water Surplus and Drought Management ("WSDM") supplemental supplies to meet expected demands in the 2008 water year. See "METROPOLITAN WATER DISTRICT SUPPLY MANAGEMENT STRATEGIES" herein.

MWD estimated in April 2008 that it will need to draw upon 665,000 AF of WSDM supplies under the current 35% SWP allocation to balance 2008 water year supply and demand. With these supplies, MWD expects to be able to meet the range of estimated demands in the 2008 water year. MWD's announcement in calendar year 2007 that it would draw from WSDM storage supplies triggered implementation of the CWA's Drought Management Plan ("DMP"). Developed with member agency input and adopted by the CWA Board in March 2006, the DMP contains a list of water management actions available to the CWA during drought conditions. These actions are organized into three stages that include: voluntary supply management, supply enhancement, and mandatory cutbacks. As part of the mandatory cutback stage, the DMP includes a supply allocation methodology. The CWA was the first major California water agency to adopt a shortage allocation plan. In February 2008, MWD adopted its Water Supply Allocation Plan for its service area. See "METROPOLITAN WATER DISTRICT SUPPLY MANAGEMENT STRATEGIES" herein. Currently, the Authority does not expect to implement mandatory cutbacks during the current calendar year. The Authority expects to authorize a modification to its water conservation ordinance in order to facilitate mandatory cutbacks in future years.

The Authority expects to present the water conservation ordinance to its Natural Resource Committee in October 2008.

Consistent with actions listed in the DMP Drought Response Matrix, in calendar year 2007 the CWA implemented several drought response measures to avoid or reduce impacts due to supply shortages. These actions included, among other things, a call for increased voluntary conservation in its service area, increased delivery of imported water into local reservoirs for carryover purposes, and spot transfer opportunities with rural water districts such as the agreements with the Butte Water District and the Sutter Extension Water District. As of March 2008, these measures have resulted in the following achievements: over 20,000 AF of carryover storage in local reservoirs, the CWA exercising the water transfer purchase option agreements that were entered into with the Butte Water District and Sutter Extension Water District, for 10,006 and 13,071 AF respectively, and Board approval of approximately \$1.8 million to launch a comprehensive advertising and marketing campaign to promote voluntary water conservation during the summer months of calendar year 2008. The CWA will continue to implement DMP action as necessary and work closely with its member agencies and MWD to monitor supply conditions and storage levels. See "RISK FACTORS – Drought Risks" in the forepart of this Official Statement.

Despite the above-mentioned actions to balance supply and demand, there is no guarantee that the short-term water supply outlook will improve. Although the CWA maintains financial reserves, it is possible that additional costs associated with demand reduction and supply enhancement could negatively affect the Water Authority's short-term financial situation. The Water Authority may compensate for increased costs or reduced water sales by adjusting water rates in succeeding years. See "WATER SYSTEM FINANCIAL OPERATIONS – Budgetary and Rate Setting Process" in the forepart of this Official Statement.

In September 2008, the Governor signed legislation, S.B. No. 1 (2nd Ex. Sess.), which authorizes the Integrated Regional Water Management Planning Act. The legislation is designed to facilitate the development of integrated regional water management plans, which are expected to further the improvement of water supply reliability, water quality and environmental stewardship of each region within the State in order to meet current and future needs. The legislation appropriates \$842 million in funding from two voter initiatives, which were approved in calendar year 2006. The legislation includes \$200 million to help stabilize the Sacramento-San Joaquin Bay Delta, help prevent catastrophic failures of levees in the Delta and accommodate pumping restrictions mandated by a federal court ruling. See "METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA - *Endangered Species Act Considerations*" herein.

Water Storage. The Olivenhain Reservoir is part of the first phase of the CWA's Emergency Storage Project, described below. The Olivenhain Reservoir has a storage capacity of 24,000 AF of water. Of the available supply, approximately 3,400 AF of water is dedicated to the Olivenhain Municipal Water District's operational use, and the remaining water is available for emergency use. The Olivenhain Reservoir is complete and is in full operational service.

Agreements with the City regarding the Emergency Storage Project have extended the CWA's contractual rights for up to 60,000 AF of storage in City-owned reservoirs. The CWA has the right to store up to 40,000 AF in San Vicente Reservoir at the terminus of the First Aqueduct and up to 20,000 AF at other City-owned reservoirs. As of January 2007, the CWA had 20,300 AF in storage in City-owned reservoirs. [Update.] Payment to the City is in the amount of \$2.20 per AF for the maximum amount of water in storage each year. The City receives a credit of \$4.00 per AF for CWA water delivered to the City from the CWA's storage account in San Vicente Reservoir. Furthermore, the first water that may be lost over the spillway is that stored by the CWA; although this happened in the very wet year of 1997-98, this is an infrequent occurrence. The CWA does have contractual rights to make a paper transfer of a

specified amount of water from reservoirs with high spillage risks to reservoirs with a lower risk of spill in order to minimize potential losses. In July 1985, two hydroelectric plants were completed to provide energy for pumping purposes. The Miramar Plant, which is adjacent to the Miramar Reservoir, has two turbine/generator units, which are currently out of service, with a nameplate generating capacity of 400 kilowatts per unit. The Alvarado Plant, adjacent to the Alvarado Reservoir, has two units with a nameplate generating capacity of 995 kilowatts per unit. A 4.5 megawatt hydroelectric generating facility was completed and placed into service in February 2007 along the Second Aqueduct in the Rancho Penasquitos area.

### **Future CWA Water Supply**

*MWD and Bay-Delta.* MWD has traditionally been the largest supplier of water to CWA. But in the aftermath of a six-year drought that ended in 1992 and a 31% mandatory cutback at the height of that drought, CWA's Board decided to gradually diversify its supply away from its heavy reliance on MWD, which, including water from the SWP and Colorado River delivered by the MWD, provided more than 95% of the CWA's water at that time. The Bay-Delta, a region of northern California that is the source of supply for the SWP and a major supplier to MWD, is primarily managed through a consortium of 130 state and federal agencies called CALFED Bay-Delta. A major effort of this consortium focuses on balancing delivery of water to the SWP with satisfying ecological concerns and mitigating degradation of the levee system that has been built up around the Bay-Delta over the decades. CALFED Bay-Delta's actions directly affect MWD's supply, which in turn affect CWA's supply of imported water not received from the Colorado River. The MWD and Bay-Delta program encompasses 12 goals in CWA's current business plan, many of which aim to increase CWA's scope of influence with financial and infrastructure decisions made by CALFED Bay-Delta and MWD that directly or indirectly affect water deliveries and costs to CWA. For Fiscal Years 2007-08 and 2008-09, the CWA has budgeted MWD and Bay-Delta program expenditures, which include among other things, monitoring, evaluating, and preparing recommendations relative to regional, state and federal issues affecting imported water quality and availability, serving as a liaison with local and non-local water agencies, and state and federal officials to promote CWA positions, planning programs and services, conducting studies, preparing administrative reports, and supporting the CWA's representatives at MWD, in the amount of \$2.99 million.

Based upon reports from the City and from CWA, the City expects its reliance on water imported from MWD to reduce from the current levels of approximately 90% to less than 40% by Fiscal Year 2019-20, provided that planned local CWA and City projects are implemented. The City expects that such water, which continues to be imported from MWD, will originate from a higher priority water right.

*Colorado River Water Supplies.* The cornerstone of the Colorado River Programs is the QSA among IID, MWD, and Coachella Valley Water District. In accordance with the terms of the agreement, the IID will transfer 60,000 AF to CWA in 2008, increasing that volume by 10,000 AF a year until calendar year 2020, when the transfer reaches 200,000 AFY. Another component of the QSA is the canal lining projects for the Coachella and All-American Canals. The Coachella Canal Lining Project has been completed and is currently delivering 21,500 AFY. The All-American Canal Lining Project is expected to deliver 56,200 AFY to CWA when complete in late 2010. Together, these two canal linings will supply 77,700 AFY when fully complete, enough to meet the needs of about 150,000 households. Combined with the implementation of the QSA, this program will considerably aid CWA's efforts at supply diversification. By calendar year 2020, the City estimates that the IID transfer, the All-American Canal Lining Project and the Coachella Canal lining will provide 267,000 AF to CWA and reduce CWA's reliance on water from MWD by at least one-half. By 2011, water transfers from the IID agreement and canal lining projects are expected to provide 20% of the region's water demands. The Colorado River Water Supplies program includes the major goals of completing construction of the All-American Canal, implementation of a public outreach campaign in the affected Imperial Valley communities and determination of the feasibility of a water transfer price-reset provision of the QSA, in which each of the

participating agencies has the opportunity to request a new pricing formula for the transferred water. See "QUANTIFICATION SETTLEMENT AGREEMENT – All-American Canal and Coachella Canal Lining Projects" herein.

*Seawater Desalination.* CWA continues to regard desalination as a key means in achieving water supply diversification. CWA has developed and adopted a desalination action plan that provides the strategy for achieving intermediate and long-range targets.

Seawater desalination is a key component of the CWA's supply diversification strategy. As such, the CWA is assisting its member agencies in pursuing the development of a local, privately owned, desalination project located adjacent to the Encina Power Station. The project will consist of a reverse osmosis desalination treatment facility as well as ancillary intake, discharge, and product water distribution pipelines and facilities. To date, nine CWA member agencies have entered into water purchase agreements with the private developer. Total demands from these agreements fully subscribe the plant's 50-million-gallon-per-day capacity. The plant could come on-line as early as 2011. Major planning milestones completed thus far include: certification of an environmental impact report by the City of Carlsbad, approval of a concentrate discharge permit by the San Diego Regional Water Control Board, and approval of a conditional Coastal Development Permit by the California Coastal Commission.

Several contingencies related to member agency agreements must be satisfied before implementation of the desalination project and its ultimate yield can be determined. These contingencies include obtaining legal entitlements for construction of the project, determination of a mutually acceptable delivery interconnection point and delivery charge, and engagement of a third party exchange agreement where physical delivery to the contracting agency is not practical. The CWA has also significantly improved its imported supply diversification through the implementation of the All-American Canal Lining Project and the Coachella Canal Lining Project. These projects are expected to provide conserved water for delivery to the CWA member agencies for 110 years, and are more reliable during droughts due to their higher Colorado River priority.

The primary focus is on CWA facilitation of the implementation of a local project in the City of Carlsbad that will provide desalinated water directly to member agencies and will account for up to 7% of the region's water supply by 2012. CWA will be evaluating other potential sources of desalinated seawater, as well as additional opportunities for brackish groundwater desalination. In [2008], CWA will complete a detailed feasibility study for a seawater desalination project adjacent to Marine Corps Base Camp Pendleton in northern San Diego County and will initiate work on a regional brine line to convey concentrate from desalination facilities proposed to be located in south San Diego County to the Southbay Ocean Outfall near the international boundary.

*CWA Water Transfer Agreements.* Core water transfers have emerged as one of the CWA's greatest alternatives to continued purchases from MWD, thus helping accomplish the CWA supply diversification goal. In general, water transfers typically involve purchasing water for a specified period of time from an agency or district that then reduces its water use by the equivalent amount. The principle behind water transfers is that market forces will work to reallocate water. The CWA/IID core water transfer, included in the QSA, is an example of this principle and will ultimately provide the CWA with 200,000 AFY by 2021. See "QUANTIFICATION SETTLEMENT AGREEMENT – Water Authority/Imperial Irrigation District Water Transfer" herein.

The cost of CWA transfers can be divided into two general components: the acquisition cost from the transferring agency and the cost to convey the water to the CWA. Conveyance cost typically introduces a third party into any transfer agreement because virtually all potential transfers to the CWA's service area rely upon using MWD, SWP, and/or U.S. Bureau of Reclamation Central Valley Project facilities to transport (or "wheel") the water. Under current State law, these public agencies are required



to provide 70% of unused capacity in their distribution systems to wheel transferred water, provided that compensation at the lawful rate is made to cover the costs and that no harm is done to other legal water users.

Transfers originating from the Colorado River and State Water Project Bay-Delta supplies involve significant environmental considerations. The primary environmental focus for both sources has been declining fisheries and aquatic ecosystems. This has resulted in greater restrictions being placed on facility operations and has created additional challenges in securing viable transfer options. See "QUANTIFICATION SETTLEMENT AGREEMENT – Quantification Settlement Agreement Litigation" and "METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA – Environmental Considerations" and "– Endangered Species Act Considerations" herein.

The CWA is also pursuing spot water transfers to provide supplemental supplies to the region during times of supply shortages. Spot transfers are short-term transfers or leases, typically agreed to and completed within one to three years. Consistent with the CWA Board of Directors' declaration in December 2007 implementing Stage 2 - Supply Enhancement actions of Drought Management Plan, staff sought to develop short-term transfer agreements with agencies north and south of the Bay-Delta region. In February 2008, the CWA Board executed one-year transfer option agreements with the Butte Water District and the Sutter Extension Water District for 10,006 AF and 13,071 AF respectively. The CWA is negotiating wheeling and related agreements with DWR and MWD necessary to convey the transfer water through SWP and MWD facilities into the CWA's service territory.

*Reclaimed Water.* CWA's reclaimed water program seeks to treat reclaimed wastewater for urban irrigation and other non-potable purposes. This program is expected to yield 5% of the region's water demand by 2011. Currently, the program conserves about 11,500 AFY. Since CWA does not own and operate a wastewater treatment plant, its reclaimed water program will continue to be implemented entirely by member agencies via public relations and educational outreach programs. A primary incentive for the existing reclaimed water program is a \$200 per AF water reclamation credit paid from CWA's local water supply development program, up to \$700,000. Additionally, CWA staff provides technical assistance to member agencies on marketing, regulatory compliance and grant applications. A majority of the goals set forth in the CWA's reclaimed water program are projected to be completed during this budget period. Those focus on partnering with member agencies, securing additional grant funding and implementing a regional public information program. MWD also offers a variable recycling credit, based on project financial need, of up to \$250 per acre-foot.

*Groundwater Storage.* In January 2008, the CWA Board approved a term sheet for groundwater storage with the Semitropic Rosamond Water Bank Authority (the "Bank Authority"). The Bank Authority is a Joint Powers Authority among the Semitropic Water Storage District, Rosamond Community Services District and Valley Mutual Water Company. The Bank Authority is developing and will operate two groundwater banks in Kern County, the Stored Water Recovery Unit adjacent to the original Semitropic Groundwater Storage bank in Kern County, and the Rosamond Water Bank in the Antelope Valley area of Kern County. In total, the Stored Water Recovery Unit and the Rosamond Water Bank will have the ability to store up to 800,000 AF of groundwater supplies.

The term sheet for groundwater storage with the Bank Authority allows the CWA to purchase 20,000 "units" from the Bank Authority, with the option to purchase an additional 10,000 "units" within two years from the first purchase. Each "unit" allows for 3 AF of storage in the Stored Water Recovery Unit or 5 AF in the Rosamond Water Bank. The purchase price for the units would be \$30,000,000. The option purchase price would be \$1,550 per "unit" or \$15,500,000 if fully exercised. The term sheet also includes fees for "puts" and "takes" from storage, power costs, and annual management, operations, and maintenance fees. Members of the CWA staff and Bank Authority staff are currently negotiating a contract based on the term sheet.

The CWA has a contract with DWR to reimburse the CWA for expenses incurred to develop groundwater conjunctive use projects that benefit the San Diego region. Purchases of shares, or "units" in groundwater banking projects are eligible expenses for reimbursement. The CWA estimates that \$26.7 million will be available for this purpose, plus an additional \$3.8 million for local groundwater studies. The State's reimbursement is contingent upon appropriation by the State Legislature, which to date has appropriated approximately \$15.5 million.

By 2011, CWA's groundwater program is projected to triple its production to 6% of the region's water demand. Nearly 30,000 AFY, or all of the projected additional supply, is expected to come from the following projects: three brackish-water groundwater recovery projects previously identified by the City, expansion of existing brackish-water groundwater recovery projects operated by two member agencies, the City of Oceanside and Sweetwater Authority and the development of a conjunctive-use project in the Santa Margarita River Basin with two member agencies, the Marine Corps Base at Camp Pendleton and the Fallbrook Public Utility District. In April 2007, the CWA Board approved an increase to the budget of \$487,000 to design, construct, and test two production wells in the City of Oceanside. The additional work is reimbursable from the City of Oceanside. A major goal of CWA's groundwater program is the expansion of the local water supply incentive program to groundwater projects to assist member agencies in reaching their groundwater production goals.

*Water Conservation.* The City and the CWA have active water conservation programs. In previous years, these programs have provided customer education and financial incentives for the installation of water saving devices such as low-flow toilets, water efficient washers and weather-based sprinkler controllers for irrigating large landscapes, parks and greenbelts. The CWA's adopted budget for Fiscal Years 2008-09 and Fiscal year 2009-10, seeks to increase water savings to more than 81,000 AFY by 2011 by shifting its focus on ultra low flush toilet and high efficiency washer voucher programs to commercial users of landscape irrigation. The annual savings from increased conservation measures is projected to make up 10% of the region's water demand in 2011.

In response to recent water supply shortages by MWD and CWA, the City declared a Stage 1 Voluntary Compliance Water Watch, which requests voluntary water use reduction. City programs such as the "Twenty Gallon Challenge" provide information to the public on the methods in which residential water use can be reduced to help the area manage potential reductions in the delivery of imported water to the area. The City expects that the success of these voluntary programs will help the area manage potential reductions in the delivery of imported water. The success of these voluntary programs will help the area manage water deliveries in the event that the MWD is required to further cut deliveries to the CWA. The City is currently updating a drought ordinance that will outline voluntary and mandatory actions that would be taken should further water supply restrictions occur.

*Local Surface Water.* CWA's local surface water program is responsible for optimizing the storage of runoff that occurs in the watersheds within CWA's service area with the storage of imported water. On average, local surface water is projected to supply nearly 7% of the region's annual water demands. An integral part of CWA's local surface water program is a surface storage operating agreement that CWA has executed with MWD. This agreement coordinates local surface water supplies and maximizes the efficient use of storage to provide supplies during peak demand periods. During the off-peak demand months of November through May, when most of the county's annual rainfall occurs, MWD delivers up to 70,000 AF to nine reservoirs in San Diego County. In peak demand months of June through October, reservoirs release water based on a formula that is agreed upon between CWA, MWD and participating member agencies in the agreement. Expansion of CWA's carryover storage capacity is also a key part of local surface supply development. By 2011, CWA expects to raise San Vicente Dam an additional 63 feet which is projected to yield an additional 100,000 AFY in local surface storage for imported supplies. Among the major goals that the CWA's local surface water program expects to achieve include updating a database of regional hydrological information with the assistance of member

agencies and issuing recommendations to the CWA Board based on the conclusions of a working group that focuses on local surface supply issues.

*Seismic Considerations.* Water conveyance facilities are designed to withstand earthquakes with minimal damage. Earthquake loads have been taken into consideration in the design of project structures such as pumping plants and hydroelectric plants. All known faults are crossed by pipelines at very shallow depths to facilitate repair in case of damage from movement along a fault. To date, no CWA facilities have suffered any material earthquake damage. The CWA's Emergency Storage Project is being designed to allow continued water service to its member agencies at a 75% level of service or better in the event of a complete interruption of water deliveries from MWD, such as might result from a severe earthquake along a fault traversing pipelines connecting with MWD, for a period of up to two months while pipelines are being repaired. On October 16, 1999, a magnitude 7.1 earthquake centered 45 miles from the Colorado River Aqueduct occurred. When it occurred, the aqueduct was running at capacity. Inspections following the earthquake revealed no structural damage. There were no interruptions in operations. No assurance can be made that a significant seismic event would not cause damage to project structures, which could thereby interrupt the supply of water from the Colorado River Aqueduct. See "RISK FACTORS - Risks Relating to Water Supply - Earthquakes, Wildfires and Other Natural Disasters" in the forepart of this Official Statement.

#### **Metropolitan Water District of Southern California**

MWD obtains its water supply from two primary sources: the Colorado River via the Colorado River Aqueduct and the SWP via the Edmund G. Grown California Aqueduct. Of the MWD water supply to CWA, more than 60% flows from the Colorado River and nearly 40% from the Bay-Delta through the SWP.

*Colorado River Water.* Under applicable laws, agreements and treaties governing the use of water from the Colorado River, California is entitled to use 4.4 million AF of Colorado River water annually, plus half of any surplus that may be available for use collectively in Arizona, California and Nevada as declared on an annual basis by the United States Secretary of the Interior.

Under the priority system that governs the distribution of Colorado River water made available to California, MWD holds the fourth priority right of 550,000 AFY and a fifth priority right of 662,000 AFY. The MWD's fourth priority right is within California's basic apportionment of 4.4 million AF, however, the fifth priority right is outside of this entitlement and therefore is not considered a firm supply of water. In addition, because of MWD's junior fourth priority right to other California contractors, under the 1931 California Seven-Party Agreement, diversions could further be restricted by certain California Indian reservations and other California users holding "present perfected rights". Since 1985, however, these entities have used less than 20,000 AF annually of their rights to approximately 49,000 AF of California's 4.4 million AF apportionment.

The Colorado River Aqueduct, which is owned and operated by MWD, transports water from the Colorado River approximately 242 miles to its terminus at Lake Mathews in Riverside County. After deducting evaporation and seepage losses in transporting and storing the water and considering maintenance requirements, up to 1.2 million AF of water a year may be conveyed through the Colorado River Aqueduct to MWD's member agencies, subject to availability of Colorado River water for delivery to MWD as described below.

*Other MWD Colorado River Supply Programs.* MWD has taken steps to enhance its share of Colorado River water through agreements with other agencies that have rights to use such water, including agreements with IID, the Central Arizona Water Conservation District and the Palo Verde Irrigation District.

*California's Colorado River Water Use Plan.* Until 2002, MWD had been able to take full advantage of its fifth priority right as a result of the availability of surplus water and apportioned but unused water. However, Arizona and Nevada increased their use of water from the Colorado River, leaving no unused apportionment available for California since the late 1990s. In addition, a severe drought in the Colorado River Basin has reduced storage in system reservoirs, resulting in no surplus water being available since 2002. Prior to 2002, MWD could divert over 1.2 million AF in any year, but since that time, MWD's deliveries of Colorado River water varied from a low of 633,000 AF in 2006 to a high of 897,000 AF in 2005. In 2007, MWD received approximately 713,500 AF of Colorado River water. See "—Quantification Settlement Agreement" and "—Colorado River Operations, Shortage, and Surplus Guidelines" below.

In response to Arizona and Nevada increasing use of their respective apportionments and the uncertainty of continued surpluses on the Colorado River, the Colorado River Board of California, in consultation with MWD, IID, Coachella Valley Water District ("CVWD"), and the CWA, has developed and released a plan for reducing California's use of Colorado River water to its basic apportionment of 4.4 million AF when necessary (the "California Plan"). In 1999, IID, CVWD, Metropolitan and the State of California agreed to the "Key Terms for Quantification Settlement among the State of California, Imperial Irrigation District, Coachella Irrigation District, and Metropolitan Water District of Southern California" (the "QSA Key Terms"), as the basis for obtaining public input regarding Colorado River use in California aimed at managing California's Colorado River supply. The QSA Key Terms were incorporated into the Colorado River Board's May 2000 California Plan that proposed to optimize the use of the available Colorado River supply through water conservation, transfers from higher priority agricultural users to Metropolitan's service area and storage programs. In March 2000, California voters approved Proposition 13, which authorized the State to issue \$1.97 billion of its general obligation bonds for water projects. Additionally, California voters approved Proposition 50 in November 2002 and Proposition 84 in November 2006, which authorized the issuance by the State of \$3.4 billion and \$5.4 billion, respectively, of its general obligation bonds for water projects. Types of water projects eligible for funding under Propositions 13, 50, and 84 include water conservation, groundwater storage, water treatment, water quality, water security and Colorado River water management projects, many of which are within the scope of the California Plan. The California Plan optimizes the use of the available Colorado River supply through water conservation, transfers from higher priority agricultural users to the CWA's and MWD's service area, and storage programs. Beginning in 2003, California's use of Colorado River water has been limited to its basic apportionment of 4.4 million AF per year (AFY). The California Plan optimizes the use of the available Colorado River supply through water conservation, transfers from higher priority agricultural users to the CWA's and MWD's service area, and storage programs.

*Colorado River Operations, Shortage, and Surplus Guidelines.* In December 2007, the Secretary of the Interior executed a Record of Decision ("ROD") for guidelines that determine potential shortage allocations among the Lower Basin states and revise reservoir operations (Colorado River Interim Guidelines for Lower Basin Shortages and the Coordinated Operations for Lake Powell and Lake Mead). Under the Guidelines, California would not have to share in any of the potential annual shortages identified by the Secretary (up to 500,000 AF). The ROD extended existing Interim Surplus Guidelines ("ISG") until 2026, which determine when surplus water is available for California, Arizona and Nevada. ISG surplus supplies are not projected to be available in 2008. Availability of ISG surplus water in future years will depend upon whether drought conditions continue and how fast storage in the Colorado River Basin can recover from present conditions. The ROD also provided a way for Lower Basin Colorado River water contractors and others to create a storage account (the "Intentionally Created Surplus"), pursuant to which surplus water may be stored for use in time of shortages. Under the Intentionally Created Surplus provisions, MWD can implement water conservation programs to create a storage account in Lake Mead of up to 375,000 AFY, for a total at any given time of no more than 1,450,000 AF. When other surplus is not available and the Colorado River is not in shortage condition, MWD could call

for the delivery of 375,000 AF of this stored water in any year. If water were needed to avoid shortages within the MWD service area, MWD would be able to call 400,000 AF.

*Environmental Considerations.* Several fish species and other wildlife species either directly or indirectly have the potential to affect Colorado River operations, thus changing power operations and the amount of water deliveries to the Colorado River Aqueduct. A number of species that are on either "endangered" or "threatened" lists under the federal and/or California endangered species acts ("ESAs") are present in the area of the Lower Colorado River. To address this issue, a broad-based state/federal/tribal/private regional partnership, which includes water, hydroelectric power and wildlife management agencies in Arizona, California and Nevada developed a multi-species conservation plan for the main stem of the Lower Colorado River (the Lower Colorado River Multi-Species Conservation Program or "MSCP"). The MSCP allows MWD to obtain federal and state permits for any incidental take of protected species resulting from current and future water and power operations and diversions on the Colorado River. The MSCP also covers operations of federal dams and power plants on the Colorado River.

*State Water Project.* Since 2003, following the execution of the QSA (defined herein) on the Colorado River, the CWA has received about 35-50% of its supply from MWD's other major source of water - the SWP. The SWP is owned by the State of California and operated by the State Department of Water Resources ("DWR"). The SWP transports Feather River water stored in and released from Oroville Dam and unregulated flows diverted directly from the Bay-Delta south via the California Aqueduct to four delivery points near the northern and eastern boundaries of MWD. The total length of the California Aqueduct is 444 miles.

MWD is one of 29 agencies that have long-term contracts for water service from DWR, but is the largest agency in terms of the number of people it serves (more than 18 million), the share of SWP water to which it is entitled (approximately 1.9 million AF, or 46% of total SWP entitlement), and the total amount of annual payments made to DWR. MWD signed a contract with DWR, which, as modified, results in MWD having 1,911,400 AF of contract amount and a "call" to a block of transferred water, if needed, so long as it pays for the financial obligations associated with the water during the call period.

Updated projections for MWD's 2003 Integrated Resources Plan (the "MWD IRP") report, its long-range planning document adopted in 2004, show that MWD expects to receive more than 650,000 AF of dry-year supply from the SWP by the year 2025. The ability to receive these supplies depends upon the relative success of implementing programs that improve the Bay-Delta, and the result of lawsuit challenges, which are discussed below. The success of these programs could also affect the amount of transfer water from the Central Valley that MWD projects it will need to fully implement the MWD IRP and the corresponding amount of transfer water to be received by the CWA and the City.

*Bay-Delta Regulatory and Planning Activities.* The supply and reliability issues affecting the SWP are largely a result of longstanding environmental problems in the Bay-Delta estuary, which provides at least a portion of the drinking water used by two-thirds of all Californians, including San Diego County residents. In addition to its importance to urban and agricultural water users, the Bay-Delta is of critical ecological importance. The Bay-Delta is the largest estuary on the West Coast of the United States and provides habitat for more than 750 plant and animal species. Human activity has contributed to the destruction of habitat, the decline of several estuarine and anadromous fish species, and the deterioration of water quality. These activities include increasing water demands from urban and agricultural uses, the dredging and filling of tidal marshes, the construction of levees, urban runoff, agricultural drainage, runoff from abandoned mines, and the introduction of non-native species. See "SAN DIEGO COUNTY WATER AUTHORITY - Current CWA Water Supply" herein.

The State Water Resources Control Board ("SWRCB") is the agency responsible for setting water quality standards and administering water rights throughout California. Decisions of SWRCB can affect the availability of water to MWD and other users of SWP water, including end-users such as the CWA and the City. The SWRCB exercises its regulatory authority over the Bay-Delta by means of public proceedings leading to regulations and decisions. These include the Bay/Delta Water Quality Control Plan (the "WQCP"), which establishes the water quality standards and proposed flow regime of the estuary, and water rights decisions, which assign responsibility for implementing the objectives of the WQCP to users throughout the system by adjusting their respective water rights. SWRCB is required by law to periodically review its WQCP to ensure that it meets the changing needs of this complex system.

Since 2000, SWRCB's Water Rights Decision 1641 ("D-1641") has governed the SWP's ability to export water from the Bay-Delta for delivery to MWD and other SWP contractors. D-1641 was challenged in a dozen lawsuits, filed primarily by Bay-Delta interests and environmental groups. These cases were consolidated in a single action. D-1641, for the most part, was affirmed by the California Court of Appeal in the State Water Resources Control Board Cases in February 2006. The California Supreme Court denied petitions for review of the Court of Appeal's decision. In December 2006, SWRCB adopted limited amendments to D-1641 to cure the two issues identified by the Court of Appeal. SWRCB also identified additional issues to review beginning in 2007, which could result in future changes in water quality objectives and flows that could affect SWP water exports. D-1641 includes a salinity objective established in the Bay-Delta to protect local agriculture.

In August 2000, the federal government and the State of California issued a ROD and related documents approving the final programmatic environmental documentation for the CALFED Bay-Delta Program, a collaborative effort among state and federal agencies to develop a long-term solution to improve water supplies in California and the health of the Bay-Delta watershed.

The Delta Vision process, established by Governor Schwarzenegger, is aimed at identifying long-term solutions to the conflicts in the Bay-Delta, including natural resource, infrastructure, land use and governance issues. The Delta Vision Blue Ribbon Task Force presented its findings and recommendations for a sustainable Delta as a healthy ecosystem and water supply source on January 17, 2008. In addition, state and federal resource agencies and various environmental and water user entities are currently engaged in the development of the Bay-Delta Conservation Plan, which is aimed at addressing ecosystem needs and securing long-term operating permits for the SWP. The Bay-Delta Conservation Plan process is scheduled for completion during the third quarter of 2009, with acquisition of appropriate permits and completion of the associated environmental impact statement/impact report. A final Delta Strategic Implementation Plan is to be submitted to the Governor and the Legislature by October 2008.

Three lawsuits were filed in the fall of 2000 challenging the CALFED Bay-Delta Program Environmental Impact Report ("EIR"). The EIR was upheld by the trial court, but invalidated by the Court of Appeal largely because the CALFED agencies failed to a project alternative of reducing exports from the Bay-Delta that, in the Court of Appeal's view, was feasible because it would curb population growth in Southern California. MWD, along with the State and certain other interested parties, petitioned the Supreme Court for review of the Court of Appeal's decision, and in January 2006, the California Supreme Court granted review of these coordinated cases. On June 5, 2008, the California Supreme Court found that an EIR is not required to consider an alternative which does not meet the basic project objectives and held that the CALFED EIR fully complied with the California Environmental Quality Act ("CEQA"). The Supreme Court also found that the Court of Appeal erred in not distinguishing between pre-existing environmental problems in the Bay-Delta and the environmental effects of the CALFED Program.

*Endangered Species Act Considerations.* The listing of several fish species as threatened or endangered under the federal and/or California Endangered Species Acts (respectively, the "Federal ESA" and the "California ESA" and, collectively, the "ESAs") have impacted SWP operations and limited the flexibility of the SWP. An annual environmental water account established under the CALFED Bay-Delta Program as a means of meeting environmental flow requirements and export limitations has helped to mitigate these impacts. Currently, five species, the winter-run and spring-run Chinook salmon, Delta smelt, North American green sturgeon and Central Valley steelhead are listed under the ESAs. In addition, in February 2008, the California Fish and Game Commission listed the longfin smelt for protection under the California ESA. The San Francisco Bay Institute, the Center for Biological Diversity and the Natural Resources Defense Council have also petitioned to list the longfin smelt for protection under the Federal ESA. The United States Fish and Wildlife Service announced in May 2008 that it will consider the Delta's longfin smelt population for such listing.

The Federal ESA requires that before any federal agency authorizes funds or carries out an action it must consult with the appropriate federal fishery agency to determine whether the action would jeopardize the continued existence of any threatened or endangered species or adversely modify habitat critical to the species' needs. The result of the consultation is known as a "biological opinion". In the biological opinion the federal fishery agency determines whether the action would cause jeopardy to a threatened or endangered species or adverse modification to critical habitat and recommends reasonable and prudent alternatives or measures that would allow the action to proceed without causing jeopardy or adverse modification. The biological opinion also includes an "incidental take statement." The incidental take statement allows the action to go forward even though it will result in some level of "take", including harming or killing some members of the species, incidental to the agency action, provided that the agency action does not jeopardize the continued existence of any threatened or endangered species and complies with reasonable mitigation and minimization measures recommended by the federal fishery agency.

Under the Federal ESA, critical habitat also must be designated for each listed species. Critical habitat has been designated for each of the listed species except for the green sturgeon. As a result of recent litigation, the United States Fish and Wildlife Service was required to designate habitat for the green sturgeon by April 30, 2008; however critical habitat for the green sturgeon has not yet been designated. In September 2008, the National Marine Fisheries Service submitted a proposal to designate critical habitat for the threatened Southern distinct population segment of North American green sturgeon pursuant to the Endangered Species Act.

Litigation filed by several environmental interest groups (*NRDC v. Kempthorne*; *Pacific Coast Federation of Fishermen's Associations v. Gutierrez*) in the United States District Court for the Eastern District of California alleges that these biological opinions and incidental take statements inadequately analyzed impacts on listed species under the Federal ESA. On May 25, 2007, Federal District Judge Wanger issued a decision on summary judgment in *NRDC v. Kempthorne*, finding the United States Fish and Wildlife Service's biological opinion for Delta smelt to be invalid. On December 14, 2007, Judge Wanger issued his Interim Remedial Order and Findings of Fact and Conclusions of Law requiring that the SWP and CVP operate according to certain specified criteria until a new biological opinion for the Delta smelt is issued. This order also set a September 15, 2008 deadline for issuance of a new biological opinion by the United States Fish and Wildlife Service. The Interim Remedial Order is no longer subject to appeal. Based on initial estimates supplied by the Department of Water Resources, MWD staff has estimated that in 2008 MWD may lose as much as 30% of its SWP supplies under certain hydrologic conditions under the Interim Remedial Order. Under the Interim Remedial Order, the SWP operations will vary in the winter and spring depending on prevailing conditions and the status of the Delta smelt.

The plaintiffs' motion for summary judgment in *Pacific Coast Federation of Fishermen's Associations v. Gutierrez*, which challenges the National Marine Fisheries Service's Biological Opinion for the salmon and other anadromous species that spawn in rivers flowing into the Bay-Delta, was argued

before Judge Wanger on October 3, 2007. On April 16, 2008, Judge Wanger issued his summary judgment ruling invalidating the biological opinion for these salmonid species. Among other things, the court's summary judgment found that the no-jeopardy conclusions in the biological opinion were inconsistent with some of the factual findings in the biological opinion; that the biological opinion failed to adequately address the impacts of SWP and Central Valley Project operations on critical habitat and that there was a failure to consider how climate change and global warming might affect the impacts of the projects on salmonid species. Judge Wanger scheduled a hearing on June 6, 2008 to evaluate the status of the salmonid species, and determine if a more extensive proceeding on interim remedies should be commenced. On July 19, 2008, Judge Wanger issued an opinion stating that the State's water-export system has put the salmonid species at risk. On July 23, 2008, Judge Wanger ordered State and federal regulators to produce an interim plan by August 29, 2008 detailing a protection plan for these salmonid species and scheduled a hearing for September 4, 2008 to discuss the interim plan. If the court proceeds with such interim remedies proceeding, the court would assess which changes in project operations should be required in the interim period before a new salmonid biological opinion is issued in March 2009. If an interim remedies proceeding is commenced, it might lead to additional changes in operation of some SWP facilities. Whether those operational changes might affect the volume or timing of exports from the SWP is difficult to determine at this time, although additional remedies would be more likely to reduce exports than increase exports.

In addition to this litigation under the Federal ESA, other environmental groups sued the DWR on October 4, 2006 in the Superior Court of the State of California for Alameda County alleging that DWR was taking listed species without authorization under the California ESA. This litigation (*Watershed Enforcers*, a project of the *California Sportfishing Protection Alliance v. California Department of Water Resources*) requests that the DWR be mandated to either cease operation of the SWP pumps, which deliver water to the California Aqueduct, in a manner that results in such "taking" of listed species or obtain authorization for such "taking" under the California ESA. On April 18, 2007, the Alameda County Superior Court issued its *Statement of Decision in Watershed Enforcers v. California Department of Water Resources*. The Statement of Decision finds that the Department of Water Resources is illegally "taking" listed fish through operation of the SWP export facilities. The Court ordered the DWR to "cease and desist from further operation" of those facilities within 60 days unless it obtains take authorization from the California Department of Fish and Game.

The DWR appealed the Alameda County Superior Court's order on May 7, 2007. This appeal automatically stays the order pending the outcome of the appeal, unless the plaintiff obtains an order from the trial or appellate court that the appeal not act as a stay based on a showing of irreparable injury. *Watershed Enforcers* filed a notice that it would not oppose a stay of the Court's order pending appeal with the Alameda County Superior Court on May 2, 2007. Also on May 7, 2007, the DWR withdrew its application, which was filed on April 9, 2007, to the Department of Fish and Game for a determination that the existing federal biological opinions are consistent with requirements for incidental take under the California ESA and executed a memorandum of understanding ("MOU") with the California Department of Fish and Game to assist in reinitiated consultations with the United States Fish and Wildlife Service and National Marine Fisheries Service for new biological opinions on the coordinated operations of the SWP and CVP as they relate to the listed species of fish. In the MOU, the DWR and the California Department of Fish and Game agree that the biological assessment and resulting biological opinions under the Federal ESA should be developed to include SWP operations that are consistent with the California ESA. After the new biological opinions and incidental take statements for the listed species of fish are completed, the DWR will apply to the Department of Fish and Game for a consistency determination under the California ESA based on the new biological opinions and incidental take statements. On January 15, 2008, all parties in the *Watershed Enforcers* appeal filed a motion asking the Court of Appeal to stay the appeal until January 1, 2009. On motion of all parties, the Court of Appeal has stayed the appeal until January 1, 2009. The MWD expects such stay of appeal to provide additional



time, during which the DWR may obtain a consistency determination under the California ESA before the Court of Appeal rules on the appeal in Watershed Enforcers.

Other issues such as the recent decline of some fisheries in the Delta and surrounding region and certain operational actions in the Delta may significantly impact MWD's water supply from the Delta and the amount of water received therefrom by the CWA and the City. SWP operational requirements may be further modified through the consultation process for new biological opinions for listed species under the Federal ESA or from the California Fish and Game's actions regarding a consistency determination under the California ESA. No assurances can be given whether or when a consistency determination will be issued under the California ESA, what the content of those opinions and determinations might be and how they may affect the SWP and CVP operations. Decisions in cases referenced here or future litigation, listings of additional species (such as the longfin smelt) or new regulatory requirements could adversely affect SWP operations in the future by requiring additional export reductions, releases of additional water from storage or other operational changes impacting water supply operations. The City cannot predict the ultimate outcome of any of the litigation or regulatory processes described above at this time or whether such outcome will result in any materially adverse impact on the operation of the SWP pumps, MWD's SWP supplies, MWD's water reserves or their impact on the City's water supplies.

Restrictions on Bay-Delta pumping beginning in calendar year 2008 under the interim remedial order in *NRDC v. Kempthorne* have resulted in reduced deliveries of SWP water to the MWD. Based on initial estimates supplied by the DWR, MWD staff estimates that MWD may lose up to 30% of its SWP supplies in calendar year 2008 under such interim remedial order. The DWR considered these estimated losses in setting MWD's SWP allocation for 2008. Actual curtailments of SWP water to MWD in 2008 will depend on fish abundance, weather, flow conditions in the Bay-Delta, numbers of fish salvaged at the project pumps, and how curtailments are divided between the SWP and CVP.

MWD's current measures to address potential water supply shortages and interruptions follow measures described in the Water Supply and Drought Management ("WSDM") Plan. These measures include calling for extraordinary conservation, cutting groundwater replenishment and agricultural water deliveries, maximizing groundwater production, acquiring additional supplies and drawing from dry-year storage. Based on DWR estimates of SWP deliveries under the Interim Remedial Order in *NRDC v. Kempthorne* and assuming an equal division of curtailments between the SWP and CVP, MWD believes that its diversified supply portfolio together with the resources actions could provide sufficient supplies for MWD to meet firm demands in calendar years 2008, 2009 and 2010, even assuming drought in the Colorado River Basin and average to dry conditions in Northern California and MWD's service area. By the end of 2010, MWD estimates that even with the resources actions, water storage would be seriously depleted. To stretch supplies, MWD ceased replenishment deliveries in May 2007 and reduced deliveries to its Interim Agricultural Water Program use by 30% beginning January 2008.

*Additional Activities.* Management of SWP supplies through water marketing and groundwater banking is expected to play an important role in meeting California water needs. MWD is currently pursuing voluntary water transfer and storage and exchange programs with the State, federal, public and private water districts and individuals.

### **Quantification Settlement Agreement**

In October 2003, the Quantification Settlement Agreement ("QSA") and its related water transfer and other agreements were signed by the US Secretary of the Interior and representatives of various Indian tribes, the US Bureau of Reclamation, CVWD, IID, MWD and SDCWA. The QSA outlines how California will reduce its overuse of Colorado River water over a 15- year period. The CWA's Colorado River Program manages the implementation of the CWA's agreements under the QSA including the water transfer agreement with IID and the concrete lining of portions of the All-American and Coachella canals.

The linchpin of the QSA is the CWA/IID water transfer agreement described below. Under the QSA, the CWA will receive 30% of its water supply from the water transfer and canal lining projects by 2020.

*Water Authority/Imperial Irrigation District Water Transfer.* Water transfers have emerged as one of the CWA's greatest alternative resources to continued purchases from MWD. Water transfers typically involve purchasing water for a specified period from an agency or district that then reduces its water use by that amount. The principle behind transfers is that market forces may reallocate water. See "SAN DIEGO COUNTY WATER AUTHORITY – Future CWA Water Supply Outlook – CWA Water Transfer Agreements" herein.

In September 1995, the CWA approved a Memorandum of Understanding with IID to negotiate a long-term transfer of conserved agricultural water. In July 1996, the CWA and IID agreed to draft terms for a Cooperative Water Conservation and Transfer Program. On April 29, 1998, the CWA and IID approved an Agreement for the Transfer of Conserved Water. Concurrently with its approval of the QSA on October 10, 2003, the CWA executed a Revised Fourth Amendment to the agreement and commenced implementation of the water transfer. The agreement provides that water saved through conservation measures in Imperial Valley will be transferred to the CWA. This water is highly reliable because it comes from IID's priority of use of the first 3.85 million AFY of the State's 4.4 million AF normal year allocation. These priorities are higher than MWD's fourth priority allocation of 550,000 AF. This means that water will likely remain available for transfer even during drought. Implementation of the water transfer began in calendar year 2003 with a transfer of 10,000 AF of water. The quantities will increase according to an agreed-upon delivery schedule, ultimately providing up to 205,000 AF of water in calendar year 2021 and declining to 200,000 AFY beginning in calendar year 2023. This amount will continue to be transferred between calendar year 2021 and as late as calendar year 2077. In calendar year 2008, the CWA will receive 50,000 AF of conserved water from this program.

*All-American Canal and Coachella Canal Lining Projects.* As part of the QSA and related contracts, the CWA was assigned MWD's rights to approximately 77,700 AFY of conserved water from the All-American Canal Lining Project and the Coachella Canal Lining Project pursuant to an Allocation Agreement among various parties to the QSA (the "Allocation Agreement"). The All-American Canal Lining Project will yield approximately 56,200 AF of Colorado River water per year and the Coachella Canal Lining Project will yield approximately 21,500 AFY. Under the Allocation Agreement, 16,000 AFY of conserved canal lining water will be allocated to the San Luis Rey Indian Water Rights Settlement Parties. The remaining approximately 77,700 AFY will be available to the CWA. Under the Allocation Agreement, IID has certain limited call rights to a portion of the conserved water, but exercise of call rights would extend the term of the deliveries to the CWA. These projects will reduce the loss of water that currently occurs through seepage and that conserved water will be delivered to the CWA. This will provide the CWA's service area with an additional 8.5 million AF of water over the 110-year life of the agreement. IID and the CVWD are responsible for managing the design, permitting, contracting, and construction of the two projects. Each of the canal lining projects is subject to the completion of necessary environmental documentation and permits. See "SAN DIEGO COUNTY WATER AUTHORITY – Future CWA Water Supply – Colorado River Water Supplies" herein.

Most of the construction work on the Coachella Canal Lining Project has been completed. The significant items of remaining work are focused on environmental mitigation and providing secondary electric power to two of the canals' six check structures. Water was first turned into the newly lined canal on December 4, 2006 and the facility was taking full flow by December 21, 2006. In December 2007, the CWA and CVWD executed an agreement that will allow up to an additional 4,850 AF of conserved water that was previously considered necessary for environmental mitigation to be available for delivery to the Authority. Upon the Bureau of Reclamation issuing a final "secretarial determination" it is anticipated that the total project yield will increase to approximately 30,850 AF. The terms of the agreement provide that the CWA will receive up to an additional 1,850 AF in calendar years 2007 and 2008, and up to 4,850

AFY thereafter. Although the actual total net supply available in any year will depend upon how much of the additional water may be necessary for environmental mitigation, the CWA expects to receive 2,500 AFY on average from the project.

IID issued notices-to-proceed to two construction contractors in May and June of 2007 for the All-American Canal Lining Project. The lining project consists of constructing a concrete-lined canal parallel to 23 miles of the existing All-American Canal from Pilot Knob to Drop 3. National Environmental Policy Act ("NEPA") and CEQA documentation is complete, environmental mitigation measures have been identified and Endangered Species Act consultations are pending. Under the current schedule, the project is expected to be completed in calendar year 2010. The CWA will receive 56,200 AF of water per year in equal monthly installments after adjusting for water allocated to the San Luis Rey Indian parties. The IID expects Kiweit Pacific Company, the contractor for Reach 1-A, to complete the Reach 1-A portion of the project by winter 2008. Ames Construction, the contractor for Reach 2 and Reach 3 of the All-American Canal Lining Project has completed approximately one-half of the lining work necessary to complete Reach 3. The IID expects Ames Construction to complete repairs to Reach 2 and the remainder of its contract by the end of summer 2008.

The calendar year 2003 Exchange Agreement between the CWA and MWD provides for the delivery of the conserved water from the canal lining projects. Pursuant to the calendar year 2003 Exchange Agreement, MWD will deliver the canal lining water for the term of the Allocation Agreement (110 years) and the CWA will pay MWD's applicable wheeling rate for each acre-foot of exchange water delivered.

*Quantification Settlement Agreement Litigation.* On November 5, 2003, IID filed a validation action in Imperial County Superior Court seeking a judicial declaration of the validity of the QSA and its related water transfer and other agreements. Other lawsuits, including an action brought by the County of Imperial ("Imperial County"), were also filed challenging the execution, approval and subsequent implementation of the QSA on various grounds including failure to comply with CEQA, violations of the Water Code, breach of trust and fiduciary duties, unconstitutional taking of property rights, and deprivation of federal civil rights under 42 U.S.C. section 1983. The CWA has been named as a defendant/respondent/cross-defendant in certain cases pertaining to the QSA and its related agreements. All of the QSA cases have been coordinated in the Sacramento Superior Court. Two rounds of pleading challenges that ended in January 2005 narrowed the cases and claims in the coordinated proceedings. In calendar year 2005 the Third District Court of Appeal granted Imperial County's petition for review of rulings dismissing one County case and dismissing the CEQA causes of action from another. The Court of Appeal then stayed all lower court proceedings pending appellate review. On June 14, 2007, the Court of Appeal affirmed the Superior Court's decision. The Court of Appeal denied a petition for rehearing in July 2007, and the time to petition the California Supreme Court expired. The QSA litigation then resumed in the Superior Court where motions were filed to dismiss some of the other QSA lawsuits and for a preliminary injunction. On January 31, 2008, the court denied the motion for a preliminary injunction, and on February 5, 2008, the court dismissed one of the lawsuits challenging the State Water Resources Control Board's decision to approve the IID-SDCWA transfer. The court also dismissed most of the parties, including all the water agencies, from a cross-complaint in the validation action, leaving state agencies as the only defendants to that cross-complaint. If one or more of the lawsuits is successful, the court could enjoin transfers anticipated to be made to CWA under the QSA totaling over 80,000 AF for the year.

A complaint filed July 19, 2005, in U.S. District Court, District of Nevada, in the matter of *Consejo de Desarrollo Economico de Mexicali, A.C. v. United States*, alleges that the Federal government and federal officials ("Federal Defendants") violated NEPA, the Endangered Species Act and other environmental laws in approving and carrying out the All-American Canal Lining Project, and that Mexican landowners are entitled to receive seepage water from the All-American Canal that will be

conserved by the lining project and conveyed to water users in California under certain QSA agreements. The court granted summary judgment to the Federal Defendants on July 3, 2006. The plaintiffs appealed, and the Ninth Circuit Court of Appeals issued an injunction against work on the All-American Canal Lining Project pending its decision on the legal challenges of the project. In April 2007 the Ninth Circuit Court of Appeals upheld the lower court decision, lifting its injunction and ordering that the case be dismissed.

An action challenging the All-American Canal lining project, *Protect Our Water and Environmental Rights v. Imperial Irrigation District* ("POWER I"), was filed in California state court in calendar year 2006, challenging IID's water conservation and transfer project and the habitat conservation plan under CEQA. The petition named IID as a respondent and named CWA, MWD, and CVWD as real parties in interest. The court granted the defendants' demurrer and dismissed the action. The plaintiffs appealed this dismissal. A hearing on the appeal has not been set.

Protect Our Water and Environment Rights also filed two other lawsuits challenging the lining project, one in federal district court in Sacramento ("POWER II") and the other in California Superior Court ("POWER III"). Both suits challenge IID's adoption in July 2006 of an addendum to the Environmental Impact Report (EIR) that IID prepared for the All-American Canal Lining Project under CEQA. In January 2007, the federal district court in POWER II dismissed the lawsuit on the ground that the complaint from Protect Our Water and Environment Rights alleged only State law claims over which such federal district court lacked subject matter jurisdiction to review. A demurrer in POWER III was sustained without leave to amend and a judgment of dismissal entered in August 2007. The plaintiffs filed an appeal of this dismissal. POWER filed a petition on April 25, 2008 requesting a stay of legal proceedings and asking the Court of Appeal to enjoin any diversion of water from the old unlined canal into the new lined one until the Court of Appeal has ruled on the appeal. The Court of Appeal denied the petition on the day that it was filed.

Success by plaintiffs in the lawsuits described above could further delay the implementation of programs authorized under the QSA or result in increased costs or other adverse impacts.

The Navajo Nation has filed litigation against the Department of the Interior, specifically the Bureau of Reclamation and the Bureau of Indian Affairs, alleging that the Bureau of Reclamation has failed to determine the extent and quantity of the water rights of the Navajo Nation in the Colorado River and that the Bureau of Indian Affairs has failed to otherwise protect the interests of the Navajo Nation. The complaint challenges the adequacy of the environmental review for the Interim Surplus Guidelines and seeks to prohibit the Department of the Interior from allocating any "surplus" water until such time as a determination of the rights of the Navajo Nation is completed. MWD filed a motion to intervene in this action. In October 2004, the court granted the motions to intervene and stayed the litigation to allow negotiations among the Navajo Nation, federal defendants and Arizona parties. In October 2007, the stay was extended until October 13, 2008. The intervening parties may observe, but may not participate in the negotiations. Negotiations are continuing. This litigation has not delayed implementation of the QSA. Any adverse impact of this litigation on MWD or its Colorado River supplies, if settlement negotiations are not successful, cannot be adequately determined at this time.

*Salton Sea Environmental Issues.* A further complicating factor in the implementation of the QSA has been the fate of the Salton Sea. The Salton Sea is an important habitat for a wide variety of fish-eating birds as a stopover spot along the Pacific flyway. Some of these birds are listed as threatened or endangered species under the California and federal endangered species acts. Located at the lowest elevations of an inland basin and fed primarily by agricultural drainage with no outflows other than evaporation, the Salton Sea is on a trend towards hyper-salinity, which has already impacted the Salton Sea's fishery. This fishery has historically been suitable habitat for the fish-eating birds. The transfer of water from IID to the CWA will reduce the volume of agricultural run-off from IID into the Salton Sea,

which in turn may accelerate the natural trend of the Salton Sea to hyper-salinity. The appropriate mitigation for impacts to the Salton Sea from the transfer of water from IID to the CWA and the larger issue of Salton Sea restoration have been addressed by State legislation implementing the QSA. In passing that legislation, the Legislature committed the State to undertake restoration of the Salton Sea ecosystem. Restoration of the Salton Sea is subject to selection and approval of an alternative by the Legislature and funding of the associated capital improvements and operating costs. The Secretary for Resources recommended an \$8.9 billion preferred alternative for restoration of the Salton Sea to the Legislature in May 2007. On January 24, 2008, the State's Legislative Analyst's Office (the "LAO") issued a report discussing current state of the Salton Sea and the California Secretary for Resources' preferred alternative for the Salton Sea's restoration. Further, the LAO, presented its own recommendations for the State Legislature to consider with respect to the restoration. These recommendations include, among other things, protecting air quality and preserving wildlife habitat as the highest of expenditure priorities, formally adopting a restoration plan, and adopting interim measures to address priority impacts such as mitigating immediate air quality impacts and habitat loss while the Legislature deliberates on the restoration issues with respect to the Salton Sea.

In August 2008, SB 187 – "Salton Sea Restoration Implementation - Funds for Proposition 84", which would authorize funds to be appropriated pursuant to a five-year restoration plan, was approved by the State Legislature and presented to the Governor. [Although bills have been introduced into the Legislature that would authorize the recommended work to proceed, no action has been approved to date.] The QSA implementing legislation also established the Salton Sea Restoration Fund, which will be funded in part by payments made by the parties to the QSA and fees on certain water transfers among the parties to the QSA. Under the QSA agreements MWD will pay \$20 per acre-foot into the Salton Sea Restoration Fund for any special surplus Colorado River water that MWD elects to take under the Interim Surplus Guidelines. MWD also agreed to acquire up to 1.6 million AF of water conserved by IID, excluding water transferred from IID to SDCWA, if such water can be transferred consistent with plans for Salton Sea restoration, at an acquisition price of \$250 per acre-foot (in calendar year 2003 dollars), with net proceeds to be deposited into the Salton Sea Restoration Fund. No conserved water has been available to MWD. MWD may receive credit for the special surplus water payments against future contributions for the Lower Colorado River Multi-Species Conservation Program (see "—Environmental Considerations" below). In consideration of these agreements, MWD will not have or incur any liability for restoration of the Salton Sea. As part of an effort to mitigate the effects of the drought in the Colorado River Basin that began in calendar year 2000, MWD elected not to take delivery of special surplus Colorado River water that was available from calendar years 2003 through 2004 and from calendar years 2006 through 2007.

*QSA Joint Powers Authority.* The Quantification Settlement Agreement Joint Powers Authority Creation and Funding Agreement (the "QSA Funding Agreement"), which was executed in October 2003 by and among the State acting by and through the California Department of Fish and Game ("DFG"), the CVWD, the IID and the CWA, established the Quantification Settlement Agreement Joint Powers Authority ("QSA JPA"). The QSA JPA is comprised of representatives from the DFG, CVWD, IID, and the CWA. The QSA JPA collects, holds, invests, and disburses funds needed for mitigation projects. The purpose of the QSA JPA is to administer the funding of environmental mitigation requirements related to QSA water transfers, make certain and limit the financial liability of the CVWD, the IID and the CWA for environmental mitigation costs, make certain and limit the financial liability of the CVWD, the IID and the CWA for Salton Sea restoration costs and allocates and the remaining financial and other risks associated with the environmental mitigation and Salton Sea restoration to the State. CVWD, IID, and the CWA are required to provide up to \$133 million (in calendar year 2003 dollars, discounted at 6% per annum) to pay for the QSA mitigation program. Under terms of the QSA Funding Agreement, the collective financial obligation of the three water agencies is capped at \$133 million, of which the CWA is responsible for \$52.2 million (in calendar year 2003 dollars). Certain of such costs will affect the water rates payable by the City and its water customers.

## Future MWD Water Supply

MWD Colorado River water supply expansion programs include the 1988 water conservation agreement between MWD and IID (the "1988 Conservation Agreement") as extended by the 1989 Approval Agreement, which allows MWD to construct and operate conservation projects. Currently, under the 1988 Conservation Agreement, IID's efforts are conserving over 105,000 AF of water per year. Under the terms of the 1988 Conservation Agreement, MWD paid for capital costs and continues to pay annual costs for specific conservation projects within IID. In return through 2003, MWD diverted from the Colorado River a quantity of water equal to the amount of water conserved by the conservation projects, which totaled between 104,940 and 109,460 AF annually from 1998 to 2003. In calendar year 2007, the conserved water augmented the amount of water available to MWD by 85,000 AF. Under an amendment to the 1988 Conservation Agreement in October 2003, 20,000 acre-feet of the total conserved volume was to be made available to CVWD. As a result, annually, between 81,160 and 81,940 AF were made available to MWD from 2004 through 2006. Under the amendment to the 1988 Conservation Agreement in May 2007, 85,000 AF was made available to MWD during 2007. The water provided under the 1988 Conservation Agreement, as amended, must be used in the calendar year the water is conserved, unless stored in a Colorado River reservoir pursuant to a separate water banking agreement.

In 1992, MWD entered into an agreement with the Central Arizona Water Conservation District ("CAWCD") for storing Colorado River water in central Arizona for the benefit of any entity outside of Arizona. Pursuant to this agreement, CAWCD created 80,900 AF of long-term storage credits that may be recovered by CAWCD for MWD. MWD, the Arizona Water Banking Authority, and CAWCD executed an amended agreement for recovery of these storage credits in December 2007. In calendar year 2007, 16,804 AF were recovered. MWD has requested that 25,000 AF be recovered in calendar year 2008, and expects to request the balance of the storage credits over the next several years. Water recovered by CAWCD under the terms of the 1992 agreement allows CAWCD to reduce its use of Colorado River water, resulting in Arizona having an unused apportionment. The Secretary of the Interior is making this unused apportionment available to MWD under its Colorado River water delivery contract.

In April 2008, MWD's Board authorized the expenditure of \$28.7 million to join the CAWCD and the Southern Nevada Water Authority ("SNWA") in funding the construction of a new 8,000 acre-foot off-stream regulating reservoir near Drop 2 of the All-American Canal in Imperial County. The reservoir will be constructed by the Bureau of Reclamation and is anticipated to be completed in late calendar year 2010. The Drop 2 Reservoir is expected to save up to 70,000 AF of water per year by capturing and storing water that would otherwise be lost. In return for its funding, MWD received 100,000 AF of water that is stored in Lake Mead until recovered, with annual delivery of up to 34,000 AF of water through calendar year 2010 and up to 25,000 AF between calendar years 2011 and 2036. Besides the additional water supply, the new reservoir will add to the flexibility of Colorado River operations.

MWD and the Palo Verde Irrigation District ("PVID") signed a program agreement for a Land Management, Crop Rotation and Water Supply Program in August 2004. This program provides up to 118,000 AF of water available to MWD in certain years. The term of the program is 35 years. Following of approximately 20,000 acres of land began on January 1, 2005. In calendar years 2005, 2006 and 2007, approximately 108,700 AF, 105,500, and 72,300 AF, respectively, of water were saved. MWD's following call is estimated to save 82,000 AF in calendar year 2008.

MWD has agreements with the CVWD and the Desert Water Agency ("Desert") that require MWD to exchange its Colorado River water for those agencies' SWP entitlement water on an annual basis. Because Desert and Coachella do not have a physical connection to the SWP, MWD takes delivery of Desert's and CVWD's SWP supplies and delivers a like amount of Colorado River water to the agencies. In accordance with an advance delivery agreement executed by MWD, CVWD and Desert, MWD delivers Colorado River water in advance to these agencies for storage in the Upper Coachella

Valley groundwater basin. In years when supplies are needed to meet local demands, MWD has the option to receive the water supply and must pay the associated SWP transportation costs and CVWD and Desert may use the stored water.

*Arvin-Edison/Metropolitan Water Management Program.* In December 1997, MWD entered into an agreement with the Arvin-Edison Water Storage District ("Arvin-Edison"), an irrigation agency located southeast of Bakersfield, California. Under the program, Arvin-Edison is obligated to return up to 70,000 AF of store water in any year to MWD, upon request. The agreement includes a "Regulation Program" and a "Transportation Program". Under the terms of the Regulation Program, Arvin-Edison will regulate the storage and delivery for MWD of up to 350,000 AF of water and currently has 209,251 AF in the program. The minimum estimated return capability for the Arvin-Edison program varies from 40,000 acre-feet per year to 75,000 AFY per year depending on hydrologic/groundwater conditions. As a result of the operational history, the long-term return capability for the program during dry years has been estimated to be 90,000 AFY. Return water will be delivered to MWD upon request through a new intertie pipeline to the California Aqueduct and by exchange of existing Arvin-Edison supplies in the California Aqueduct. The agreement terminates on December 31, 2022 with provisions for automatic extension if all stored water has not been returned.

The agreement also provides a Transportation Program pursuant to which the MWD is provided priority rights to convey water acquired by MWD from third parties through the Arvin-Edison facilities to the California Aqueduct for ultimate delivery to MWD. The agreement will terminate on November 4, 2035 unless extended. To facilitate the program, new wells, spreading basins and a return conveyance facility connecting Arvin-Edison's existing facilities to the California Aqueduct have been constructed.

*MWD California Aqueduct Dry-Year Transfer Program.* MWD has entered into agreements with the Kern Delta Water District, the Mojave Water Agency (Demonstration Water Exchange Program) and the San Bernardino Valley Municipal Water District to insure against regulatory and operational uncertainties in the SWP system that could impact the reliability of existing supplies. The total potential yield for the three agreements is approximately 115,000 AF of water per year. MWD entered into an agreement with San Bernardino Valley Municipal Water District in April 2001 to coordinate the use of facilities and SWP water supplies. The agreement allows for the minimum purchase of 20,000 AF on an annual basis with the option to purchase additional water when available. Also, the program includes 50,000 AF of carryover storage. In addition to water being supplied using the SWP, the previously stored water can be returned using an interconnection between the San Bernardino Central Feeder and MWD's Inland Feeder. In Fiscal Year 2006-07, MWD took delivery of 30,000 AF from San Bernardino Valley Municipal Water District under the agreement. This program terminates on December 31, 2014. MWD entered into an agreement with Kern Delta Water District on May 27, 2003, for a groundwater banking and exchange transfer program to allow MWD to store up to 250,000 AF of State Water Contract water in wet years and permit MWD, at MWD's option, a return of up to 50,000 AF of water annually during hydrologic and regulatory droughts. Additionally, MWD entered into a groundwater banking and exchange transfer agreement with Mojave Water Agency on October 29, 2003. The agreement allows for MWD to store water in an exchange account for later return.

*Groundwater Storage.* In 1994, MWD entered into a water banking and exchange program with the Semitropic Water Storage District and its improvement districts ("Semitropic"), located adjacent to the California Aqueduct north of Bakersfield, to store water in the groundwater basin underlying land within Semitropic. The program also entitles MWD to withdrawal and exchange rights for Semitropic's SWP supplies. The agreement terminates in November 2035.

In 1999, MWD became fully vested for 35 percent of the 1,000,000 acre-foot banking project. MWD has a storage allocation of 350,000 AF and currently has 343,327 AF in the program. MWD is entitled to 31,500 AFY (minimum) of pump back capacity and 46,550 AFY (minimum) of entitlement

exchange rights. Additionally, MWD has the ability to use other banking partner's rights when they are not being used. As a result, the estimated minimum return capability for MWD is 107,000 AFY.

*Water Conservation.* The central object of MWD's water conservation activities is to help ensure adequate, reliable and affordable water supplies for Southern California by actively promoting efficient water use. The importance of conservation to the region has increased in calendar year 2008 because of drought conditions in the State Water Project watershed and court-ordered restrictions on Bay-Delta pumping.

MWD's conservation activities have largely been developed to assist its member agencies in meeting the "best management practices" ("BMP") of the California Urban Water Conservation Council's Memorandum of Understanding Regarding Urban Water Conservation in California ("CUWCC MOU") and to meet the conservation goals of the calendar year 2004 Integrated Resources Plan Update. Under the terms of the CUWCC MOU and MWD's Conservation Credits Program, MWD co-funds member agency conservation programs designed to achieve greater water use efficiency in residential, commercial, industrial, institutional and landscape applications. The calendar year 2004 Integrated Resources Plan Update estimates that 865,000 AF of water will be conserved annually in Southern California by calendar year 2010, when all sources of conservation are considered, including active conservation from incentive programs, codes and regulations directed at water saving methods and devices and consumer response to retail rate increases. Direct spending by MWD on active conservation incentives from Fiscal Year 1989-90 through Fiscal Year 2006-07 was \$205 million. The calendar year 2004 Integrated Resources Plan Update estimates that 1,100,000 AF of water will be conserved annually in Southern California by calendar year 2025.

In August 2007, MWD launched a significant public outreach campaign to urge consumers and businesses to voluntarily save water during current record dry conditions. The campaign combines radio, print and on-line advertising with media and community outreach efforts. Along with the message to save water, the campaign is intended to educate the public about the uncertainties of future water supplies. MWD's Board also authorized agreements with public agencies to provide financial incentives for water saving measures, ranging from \$195 to \$500 per acre-foot of potable water saved, up to a maximum of \$15 million for the Public Sector Water Efficiency Partnership Demonstration Program. This program aims to continue public support for conservation through public agency accomplishments and efforts. MWD estimated total water savings from this program of 40,000 AF. The campaign was stepped up following MWD's declaration of a regional Water Supply Alert on June 10, 2008. MWD urged cities, counties and water districts in its service area to achieve extraordinary conservation by adopting and enforcing drought ordinances, accelerating public outreach and conservation messaging, and developing additional local supplies. MWD estimates that conservation resulting from these measures could reduce the demand for imported water supplies by about 200,000 AF over the twelve months following this declaration. If necessary, MWD could implement its Water Supply Allocation Plan, resulting in mandatory water allocations, prior to calendar year 2010 to reduce water use and drawdowns from water storage reserves.

### **Metropolitan Water District Supply Management Strategies**

MWD's current measures to address potential water supply shortages and interruptions include calling for extraordinary conservation, cutting groundwater replenishment and agricultural water deliveries, maximizing groundwater production, acquiring additional supplies and drawing from storage accounts. MWD suspended groundwater replenishment deliveries on May 1, 2007, and cut deliveries under the IAWP by 30% on January 1, 2008. In addition, MWD is pursuing water transfers, including negotiations with water agencies in the Sacramento and San Joaquin Valleys for transfers. MWD is calling for maximum fallowing in MWD's agricultural land management program within PVID starting in August 2008 and is working with the State of Arizona to withdraw water previously stored in Arizona.



MWD's forecast of water supplies over the next three years, following reductions of SWP deliveries under the Interim Remedial Order in *NRDC v. Kempthorne* and considering dry conditions in the SWP watershed in calendar year 2008 (see "METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA— State Water Project" herein), includes the impact of these and similar anticipated resources actions. Based on Department of Water Resources estimates of SWP deliveries under the preliminary ruling, assuming an equal division of curtailments between the SWP and Central Valley Project, MWD is planning to meet firm demands in calendar years 2008, 2009 and 2010. However, MWD is withdrawing supplies from surface and groundwater storage to meet current demands. Anticipating that storage could be seriously depleted by the end of calendar year 2010, MWD and its member agencies are calling for voluntary water conservation to lower demands and reduce drawdowns from water storage.

MWD staff, working with member agency staff, prepared its Water Supply Allocation Plan based on the principles contained in MWD's Water Surplus and Drought Management Plan. The Water Supply Allocation Plan was approved by the Board in February 2008. The Water Supply Allocation Plan provides a formula for equitable distribution of available supplies in case of extreme water shortages within MWD's service area. A separate action of Board of the MWD will be required to impose the Plan and subject water deliveries to its allocation formula.

The Central Basin Municipal Water District ("Central Basin") filed litigation against MWD in Los Angeles Superior Court, Central District, on April 16, 2008 challenging MWD's adoption of the Water Supply Allocation Plan. The complaint alleges that the Water Supply Allocation Plan violates Central Basin's preferential right to purchase of water and, if implemented, will be a breach of Central Basin's member agency purchase; that MWD inappropriately relied on exemptions under CEQA to avoid CEQA compliance; that the Board's adoption of the Water Supply Allocation Plan failed to address "environmental justice"; that the Water Supply Allocation Plan's penalty rate is unfair, unreasonably discriminates against Central Basin and is an unauthorized "special tax" enacted without voter approval; and that adoption of the Water Supply Allocation Plan violated California and United States constitutional rights regarding impairment of contract, due process and equal protection. The complaint seeks a writ of mandate setting aside adoption of the Water Supply Allocation Plan and seeks recovery of attorney's fees and other litigation costs. The Los Angeles Superior Court held two hearings on the issue and ordered the case transferred to the San Francisco Superior Court on June 24, 2008.

**APPENDIX D**

**EXCERPTS FROM THE AUDITED FINANCIAL STATEMENTS OF  
THE CITY OF SAN DIEGO FOR FISCAL YEARS 2005-06 AND 2006-07**

**EXCERPTS FROM THE AUDITED FINANCIAL STATEMENTS OF  
THE CITY OF SAN DIEGO FOR FISCAL YEAR 2005-06**

000492



**JERRY SANDERS**  
MAYOR

March 21, 2008

Honorable City Council Members and the Citizens of the  
City of San Diego, California

San Diego City Charter § 111 requires the City to submit an annual report, including a Statement of Net Assets, and requires that all accounts of the City be audited by an independent auditor. Pursuant to this requirement, the Comprehensive Annual Financial Report ("CAFR") of the City of San Diego ("City") for the fiscal year ended June 30, 2006, is hereby submitted. The audit firm of Macias Gini & O'Connell LLP has issued an unqualified opinion on the City of San Diego's financial statements. The independent auditor's report is located at the front of the financial section of this report.

The CAFR has been prepared in conformance with the principles and standards for reporting as set forth by the Governmental Accounting Standards Board (GASB). Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the management of the City and its related agencies. Our objective is to provide you with reasonable, rather than absolute, assurance that the financial statements are free of any material misstatements. Additionally, the City continues to construct and improve a comprehensive internal control framework in order to ensure acceptable management of taxpayer funds.

To the best of our knowledge and belief, the data as presented, is accurate in all material respects; it is presented in a manner designed to present fairly the financial position and results of operations of the governmental activities, business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining funds of the City and its related agencies; and all disclosures necessary to enable the reader to gain an understanding of the City's, as well as its related agencies', financial activities have been included.

The City wishes to bring to the attention of the reader for careful consideration Notes 12, 13, and 18 to the Financial Statements, which address, among other matters, (1) the cease-and-desist order imposed on the City by the Securities and Exchange Commission for violations of the federal securities laws that occurred in 2002 and 2003, (2) related investigative reports of Vinson & Elkins LLP, Kroll Inc. and the law offices of Willkie, Farr and Gallagher LLP, serving as the audit committee for the City of San Diego (Kroll Report), Navigant Consulting, Inc. (as it relates to San Diego City Employees Retirement System (SDCERS)), and the City Attorney of the City of San Diego, and (3) the unfunded actuarial accrued liabilities of the City's pension and retiree health obligations. These notes, along with the other financial and operational data included in the City's CAFR, must be read in their entirety to obtain a complete understanding of the City's financial position.

A narrative introduction, overview, and analysis of the financial statements can be found in Management's Discussion and Analysis (MD&A) which immediately follows the independent auditor's report. The MD&A complements this letter of transmittal and should be read in conjunction with it.

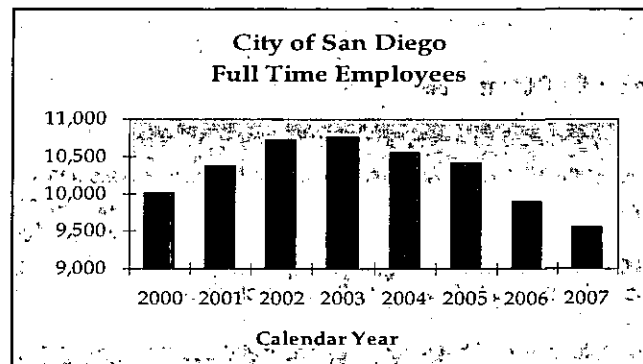
The CAFR is organized into three sections:

- **The introductory section** includes information about the organizational structure of the City, the City's economy, and selected other financial information.
- **The financial section** is prepared in accordance with Governmental Accounting Standards. It includes the MD&A, the independent auditor's report, the audited basic financial statements, notes to the basic financial statements, required supplementary information, and supporting statements and schedules.
- **The statistical section** contains historical statistical data on the City's financial data and debt statistics, as well as miscellaneous physical, demographic, economic, and social data of the City.

## PROFILE OF THE GOVERNMENT

### City Profile

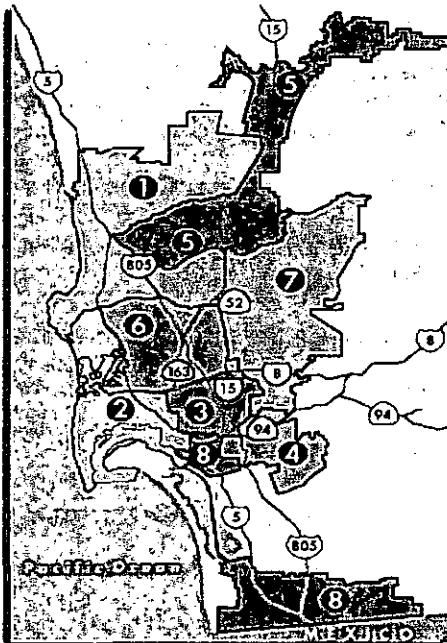
The City of San Diego was incorporated in 1850. The City is comprised of 403 square miles and, as of January 1, 2007, the California Department of Finance estimates the population to be 1,316,837. The City, with approximately 9,600 full-time employees, provides a full range of governmental services which include police and fire protection, sanitation and health services, the construction and maintenance of streets and infrastructure, recreational activities and cultural events, and the maintenance and operation of the water and sewer utilities.



### Governing Structure

The City operates and is governed by the laws of the State of California and its own Charter which was adopted by the electorate in 1931 and has been subject to periodic amendments since adoption. The City is currently operating under a strong-mayor form of government. The departure from the City's previous Council-Manager form of government was approved by a vote of the public and became effective January 1, 2006. The Mayor is elected at large to serve a four-year term.

### City of San Diego Council District Map



The charter amendment adopting the strong-mayor form of government is in effect for five years, and pending a voter approved extension or modification, sunsets on December 31, 2010. Under the strong-mayor form of government, the Mayor is the Chief Executive Officer of the City and has direct oversight over all City functions and services except for the City Council, Personnel, City Clerk, Independent Budget Analyst (IBA), and City Attorney's departments. The Office of the Independent Budget Analyst was established by the City Council to assist the Council in the conduct of budgetary analysis and in the making of budgetary, financial, and policy decisions. The City Council also established a Budget and Finance Committee to aid in the review of the annual budget, capital improvement programs, financial reports, taxes, fees, assessments, and IBA reports. Additionally, the City Council established an Audit Committee to provide independent, legislative oversight of the City's accounting and financial reporting processes, financial internal controls, internal financial audit function, and audits of the City's financial statements.

Under this form of government, the Council is composed of eight members and is presided over by the Council President, who is selected by a majority vote of the Council. The Mayor presides over Council in closed session meetings of the Council. The Council retains its legislative authority; however, all council resolutions, except for appropriations ordinances, are subject to a veto of the Mayor. The City Council may override a Mayoral veto with five votes. In addition, the City has an elected City Attorney who is the chief legal advisor of and attorney for the City and all departments. The City Attorney serves a four-year term.

Current Elected Officials  
(as of the issuance of this report)



Mayor Jerry Sanders

District 1  
Council President Scott Peters



District 5  
Councilmember Brian Maienschein

District 2  
Councilmember Kevin Faulconer



District 6  
Councilmember Donna Frye

District 3  
Councilmember Toni Atkins



District 7  
Councilmember Jim Madaffer

District 4  
Council President Pro Tem  
Tony Young

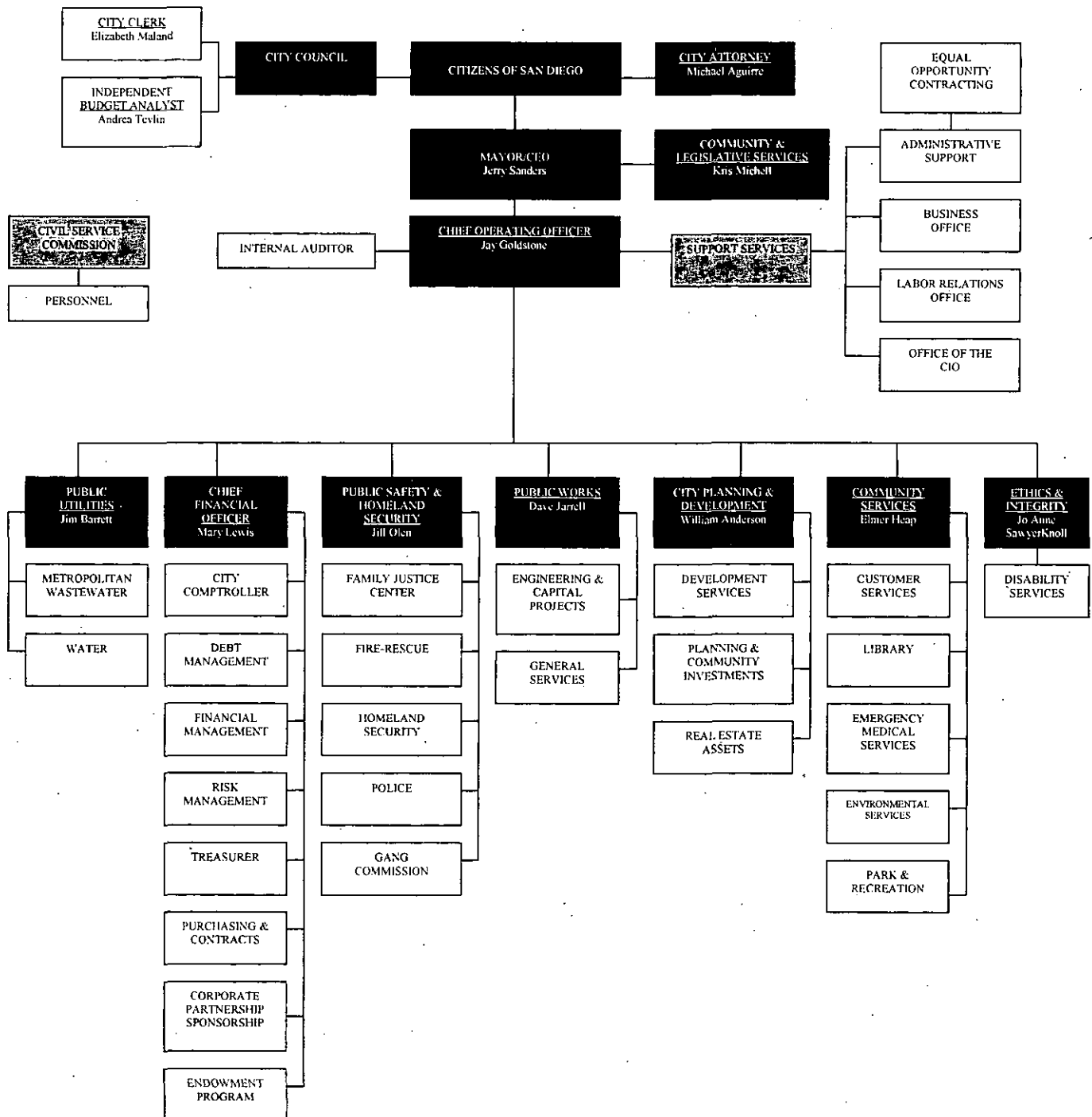


District 8  
Councilmember Ben Hueso



City Attorney  
Michael Aguirre

# City of San Diego Organization Chart (As of issuance of this report)



### Financial Reporting Entity

In accordance with Governmental Accounting Standards Board Statement 14, the following component units are incorporated into the accompanying financial statements:

- Centre City Development Corporation (CCDC)
- City of San Diego Metropolitan Transit Development Board Authority (MTDB)
- Redevelopment Agency of the City of San Diego (RDA)
- San Diego Data Processing Corporation (SDDPC)
- San Diego Housing Commission (SDHC)
- San Diego Open Space Park Facilities District #1
- Community Facility and Other Special Assessment Districts
- Convention Center Expansion Financing Authority (CCEFA)
- San Diego City Employees' Retirement System (SDCERS)
- Public Facilities Financing Authority (PFFA)
- San Diego Convention Center Corporation (SDCCC)
- San Diego Facilities and Equipment Leasing Corporation (SDFELC)
- San Diego Industrial Development Authority (SDIDA)
- Southeastern Economic Development Corporation (SEDC)
- Tobacco Settlement Revenue Funding Corporation (TSRFC)

Additionally, the City participates in a joint venture operation with a private company to provide for emergency medical and medical transportation services. This joint venture is a limited liability company named San Diego Medical Services Enterprise. The financial impact of the joint venture is displayed in the governmental funds balance sheet.

### Budgetary Process

Pursuant to the City Charter, an annual budget is presented by the Mayor to the City Council for consideration. Set forth in this budget are the anticipated revenues and expenditures of the general fund, certain special revenue funds, enterprise funds, and certain debt service funds for the ensuing fiscal year. Additionally, project-length financial plans are presented to and adopted by council for the capital projects funds. The level of budgetary control (the level at which expenditures cannot legally exceed the appropriated amount) is maintained at the fund, department, and object class level. Object classes are defined as salaries and non-personnel expense (including employee benefits). Copies of the City's Budgets are available at the Financial Management Office located at 202 C Street, MS8A, San Diego, CA 92101.

The City also maintains an encumbrance accounting system as one technique of accomplishing budgetary control. Encumbered amounts are reported as reservations of fund balances since the commitments are expected to be honored in subsequent periods.

### FACTORS AFFECTING FINANCIAL CONDITION

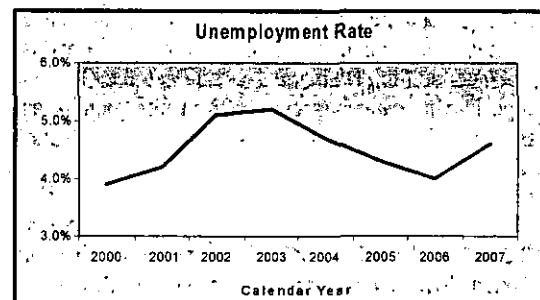
#### Economic Factors

##### Income

In January 2007, the San Diego Association of Governments (SANDAG) reported that between 2000 and 2006, the median household income in the San Diego region rose by 42.4%, from \$45,826 to \$65,238.

##### Unemployment

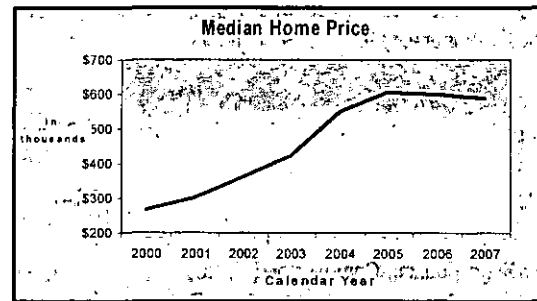
The unemployment rate is a critical indicator of the relative strength in the local economy. According to the State of California Employment Development Department, the City of San Diego's unemployment rate was 4.6% for the calendar year 2007. This reflects a .6% decrease from a 10 year high of 5.2% in the calendar year 2003, and a .6% increase from calendar year 2006. The City of San Diego's unemployment rate is even with the national average and .8% below the average for the State of California for the calendar year 2007.





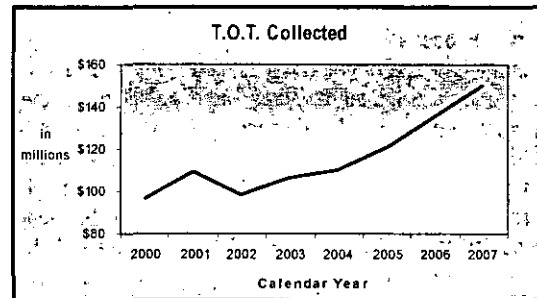
### Housing and Construction

According to a report by the National Association of Realtors, the median residential home price in the San Diego area dropped 2% from calendar year 2006 to 2007 and dropped 9.8% from the 4<sup>th</sup> quarter of 2006 to the 4<sup>th</sup> quarter of 2007. However, median residential home prices in the San Diego area increased 125% from calendar years 2000 to 2005. Home sales during this growth in median home prices have resulted in stronger than average property tax returns for the City and have fueled increased activity in the construction sector. However, there has recently been a slowing in the housing market and a softening in housing prices, and therefore, the recent growth in property tax revenues may not continue and may in fact decline.



### Tourism

The City of San Diego has continued to experience a growth in tourism during calendar year 2007, resulting in a 10.7% increase in Transient Occupancy Tax (TOT) collections from calendar year 2006, and a 38.2% increase from calendar year 2001. According to the San Diego Convention & Visitors Bureau, average occupancy rates of hotels located in the San Diego area declined during calendar year 2007 by approximately 0.2%; however, average daily room rates increased by approximately 6.0%, resulting in a net increase in TOT collections. Additionally, a total of 29.2 million visitors spent approximately \$7.3 billion at local businesses in the San Diego area during calendar year 2007.



### Water Supply

The City of San Diego is located in a semi-arid coastal climate environment and receives an average annual rainfall of 10.21 inches. San Diego has a population of approximately 1.3 million and the population is projected to increase by 26% in the next 25 years. This growth is projected to increase demand for potable water by 21%. For the Fiscal Year ended June 30, 2007, the City's average daily water use, including deliveries to the City of Del Mar and California American Water Company (Cal-Am) was approximately 221 Million Gallons per Day (MGD), with peak day demands as high as 291 MGD. The overwhelming majority of the City's water supply is imported.

The City currently receives its water supply from two sources: (1) water imported by the San Diego County Water Authority (CWA) and (2) local runoff. For the Fiscal Year ended June 30, 2007, local run off accounted for less than 10% of the City's water supply. This source is dependent upon rainfall and is seasonal and variable in nature. The balance of the City's water supply is imported from Northern California and the Colorado River and provided to the City by the CWA, of which the City of San Diego is a member agency. CWA in turn, purchases the majority of its water from the Metropolitan Water District of Southern California (MWD), which is comprised of 26 public water agencies. CWA also has rights to purchase additional supplies of water from the Imperial Irrigation District (IID), and water supplies dedicated to CWA from water-conserving canal lining projects on the All-American and Coachella Canals. The City is the largest purchaser of water from CWA. During the Fiscal Year ended June 30, 2007, the Water Department purchased approximately 229,682 AF of water from the CWA at a cost of \$113.3 million. The City's water purchases from CWA represented approximately 34% of CWA's total water deliveries and approximately 91.7% of the water produced by the City was purchased from CWA, with the balance coming from runoff collected in the City's reservoirs.

As of December 17, 2007, MWD indicated that it had sufficient water supplies in storage to sustain a supply/demand scenario similar to 2007 through calendar year 2008 with enhanced conservation efforts beginning immediately. The majority of MWD's current water supplies comes from the State Water Project (SWP) and originates from the Sacramento-

San Joaquin Bay-Delta before being pumped into the California Aqueduct for transportation to Southern California. On August 31, 2007, a federal court ordered state and federal water managers to reduce pumping out of the Delta during certain times of the year in order to protect the Delta Smelt, an endangered fish species. It is unknown how long these restrictions will be in place but they are expected to last at least one year.

MWD estimates that the court order will reduce the amount of SWP water available to MWD by up to 30% in 2008. MWD and CWA are actively pursuing spot water transfer options to offset these reductions. Colorado River deliveries to MWD and CWA remain firm in the near future, minimizing the water supply reliability impacts of the SWP reductions on San Diego. The Mayor, in coordination with CWA, has urged residents and businesses of San Diego to adopt water conservation practices at home and at their place of work. The City has also taken a leadership position in advocating a more deliberate response to water conveyance around the Delta, thereby avoiding the current judicial restrictions on the pumps. The Mayor hosted a meeting of Southern California City Mayors in San Diego as well as a "Big Ten" City Mayors' meeting in Sacramento to discuss possible solutions with input from water experts. The Water Department will continue to monitor the current and near term water supply situation, in consultation with its imported water provider, to effectively manage conservation efforts.

### **Regulatory Actions**

In November 2006, the United States Securities and Exchange Commission (SEC) entered an Order (the "Order") sanctioning the City of San Diego for committing securities fraud in connection with the 2002 and 2003 offer and sale of over \$260 million in municipal bonds and for preparing and filing information pursuant to continuing disclosure agreements under Exchange Act Rule 15c2-12 with respect to \$2.29 billion in outstanding City bonds and notes. The findings contained in the Order were made pursuant to the City's offer of settlement. To date, the SEC has not taken enforcement action against any City officials or employees; however, the SEC, in the Order, concluded that the City, through its officials, acted with scienter.

In the Order, the SEC found that at the time of these offerings, City officials knew that the City faced severe difficulty funding its future pension and health care obligations unless new revenues were obtained, pension and health care benefits were reduced, or City services were cut. The SEC found that the City's looming financial crisis resulted from (1) the City's intentional underfunding of its pension plan from fiscal year 1997; (2) the City's granting of additional retroactive pension benefits since fiscal year 1980; (3) the City's use of the pension fund's assets to pay for the additional pension and retiree health care benefits since fiscal year 1980; and (4) the pension plan's less than anticipated earnings on its investments in fiscal years 2001 through 2003. The SEC found that despite the magnitude of the problems the City faced in funding its future pension and retiree health care obligations, the City conducted five separate municipal bond offerings, raising more than \$260 million, without disclosing these problems to the investing public. The SEC found that in each of these offerings, the City prepared disclosure documents that are used with municipal securities offerings—that is, preliminary official statements and official statements—and made presentations to rating agencies. In addition, in 2003 it prepared and filed misleading information pursuant to continuing disclosure agreements under Exchange Act Rule 15c2-12 with respect to \$2.29 billion in outstanding City bonds and notes.

The SEC credited the City with having taken remedial action before the Order was issued and found that since 2005 the City has implemented several remedial measures with a view to detect and prevent securities violations. Specifically, the City has terminated certain officials in the City Manager's and Auditor and Comptroller's offices or has allowed them to resign. The City has hired full time municipal securities attorneys who are responsible for coordinating the City's public disclosure and who have conducted continuing education for the City's deputy attorneys on the City's disclosure requirements.

The SEC credited the City with hiring new outside professionals including new auditors for its fiscal year audits. The SEC also found that the City hired individuals not affiliated with the City to act as the City's audit committee to conduct an investigation of the City's prior disclosure deficiencies and make recommendations to prevent future disclosure failures. The SEC found that the City has also hired new disclosure counsel for all of its future offerings, who will have better and more continuous knowledge on the City's financial affairs. The SEC found that the disclosure counsel has conducted seminars for City employees on their responsibilities under the federal securities laws.

The SEC found that the City has also enacted ordinances designed to change the City's disclosure environment:

1. The City created a Disclosure Practices Working Group, comprised of senior City officials from across city government. The Working Group is charged with reviewing the form and content of all the City's documents and materials prepared, issued, or distributed in connection with the City's disclosure obligations relating to securities issued by the City or its related entities; and conducting a full review of the City's disclosure practices and to recommend future controls and procedures.
2. The Mayor and City Attorney must personally certify to the City Council the accuracy of the City's official statements.

3. The City Auditor & Comptroller must annually evaluate the City's internal financial controls and report the results to the City Council.

As part of the settlement with the SEC, the City agreed to cease and desist from future securities fraud violations. The City also agreed to retain an Independent Consultant acceptable to the SEC. The Independent Consultant is required to conduct annual reviews for a three-year period, following the November 2006 Order, of the City's policies, procedures, and internal controls regarding its disclosures for offerings, including disclosures made in its financial statements, pursuant to continuing disclosure agreements, and to rating agencies. The Independent Consultant is also required to review, for the three year period, the procedures and internal controls regarding the City's hiring of internal personnel and external experts for disclosure functions, and the implementation of active and ongoing training programs to educate appropriate City employees, including officials from the City Auditor and Comptroller's office, the City Attorney's office, the Mayor, and the City Council members regarding compliance with disclosure obligations.

The Independent Consultant is required to make recommendations concerning related policies, procedures, and internal controls with a view to assuring compliance with the City's disclosure obligations under the federal securities laws. The Independent Consultant is to assess, in years two and three, whether the City is complying with its policies, procedures, and internal controls, whether the City has adopted any of the Independent Consultant's recommendations from prior year(s) concerning such policies, procedures, and internal controls for disclosures for offerings, and whether the new policies, procedures, and internal controls were effective in achieving their stated purposes.

On June 7, 2007, the Initial Report of Independent Consultant to the City of San Diego (the "Independent Consultant's Report") was released. The purpose of the Independent Consultant's Report was to describe the review and assessment of the City's policies, procedures, and internal controls regarding i) its financial and other disclosures, ii) the hiring of internal personnel and external experts for disclosure functions, and iii) the implementation of active and ongoing training programs to educate appropriate City employees regarding compliance with disclosure obligations, and to provide conclusions and recommendations with respect to these matters. (See Note 18 for additional information).

Additionally, the Independent Consultant's Report recognizes the complexity of the City's issues and includes numerous actions that are planned to be addressed in the future, including:

- Ongoing analysis and observation by the Independent Consultant of the City's disclosure process, including participation in future offering disclosure processes,
- Implementation of a new Enterprise Resource Planning (ERP) system,
- Ongoing training for the City Council, City Officials, and City employees, and
- Hiring a qualified internal auditor to provide reliability of the City's internal control structure.

The Independent Consultant observed that the City had made progress with its remediation efforts, but that there is much left to be done that will require an intensive and substantial effort.

On July 23, 2007, the SEC issued a letter to the City and to the Independent Consultant recognizing the recommendations outlined in the Independent Consultant's Report and indicating its understanding that subsequent reports from the Independent Consultant would provide more complete, specific, and concrete recommendations with specific deadlines. The SEC also requested a response from the City in regards to the recommendations outlined in the Independent Consultant's Report, including an estimated timeframe for implementation of the recommendations.

On September 25, 2007, the City responded to the SEC and this response was approved by Council Resolution No. 303021. This response to the SEC is summarized as follows:

- The former CFO, along with representatives of the Audit Committee and the Independent Budget Analyst, interviewed candidates for the Internal Auditor (City Auditor). The candidate selected began work on October 22, 2007. In its 2007 Final Report dated October 4, 2007, the Charter Review Committee recommended a separation of the internal audit function from the comptroller and management duties. This revision will need to be approved by a vote of the public. (See March 3, 2008 O-19718 disclosure discussed below.)
- The City has established an Audit Committee comprised of 3 Council members and an ad hoc committee of 3 outside advisors who bring extensive technical expertise to the Committee. The ad hoc committee began serving September 10, 2007. The Charter Review Committee, in its Final Report dated October 4, 2007, has recommended a Charter change which would formally establish a five-person Audit Committee composed of two members of the City Council,

- one of whom shall serve as chair, and three members of the public. (See March 3, 2008 O-19718 disclosure discussed below.)
- The City has selected a software vendor and has begun implementation of an enterprise resource system. The current schedule calls for the system to be operable, in parallel, by October 2008. Additionally, the implementation of a human resource/payroll system is expected to be completed by January 2009.
  - The CFO position was established in calendar year 2006 and all financial related activities and responsibilities of the Primary Government, including Comptroller and debt issuance functions, fall under this position, with exception to the oversight of the Internal Auditor. (See March 3, 2008 O-19718 disclosure discussed below.)
  - The City is evaluating the Independent Consultant's recommendation to consider moving toward a shelf-like disclosure system. The City has made many improvements to internal controls regarding the release of financial information to the public capital markets (e.g. creation of the DPWG, CFO, and Audit Committee). Accordingly, any shelf-like registration would take into consideration procedures currently in place which were designed to ensure that the City would not make misleading statements or omissions to the market place in the future.

On March 3, 2008, Council approved O-19718 for the purpose of submitting to the voters a ballot proposition amending the City Charter. The ballot measures will be proposed at a Municipal Election to be consolidated with the Statewide Primary Election on June 3, 2008, and are summarized below:

- Establish the position, roles and responsibilities of the Chief Financial Officer including the clarification that all responsibilities, authority and power conferred upon the Auditor and Comptroller in the Charter shall be transferred to, assumed and carried out by the Chief Financial Officer.
- Define the composition of the Audit Committee as an independent body consisting of five members. Two members shall be Councilmembers and are to be appointed by the Council, one of whom shall serve as Chair of the Audit Committee. The other three members shall be from the public, appointed by the Council from a pool of candidates which are recommended by a screening committee. The screening committee is comprised of a member of Council, the Chief Financial Officer, the Independent Budget Analyst and two outside financial experts appointed by the other three members of the screening committee and confirmed by the Council.
- Establish the position, roles and responsibilities of the Office of the City Auditor. The City Auditor shall be appointed by the City Manager, in consultation with the Audit Committee, and confirmed by the Council.
- Establish the position, roles and responsibilities of the Independent Budget Analyst. The Council shall appoint the Independent Budget Analyst, who shall serve at the pleasure of the Council and may be removed from office by Council at any time.
- Establish the position, roles and responsibilities of the City Treasurer. The City Treasurer shall be appointed by the City Manager, and no longer needs confirmation by a majority of the members of the Council.

### **Financial Information**

#### **Pension Benefits**

In fiscal year 1927, the City established the San Diego City Employees' Retirement System ("SDCERS"), a public employee retirement system. The pension plan ("Plan") is a defined benefit plan and is administered by the SDCERS' Board to provide retirement, disability, death, and survivor benefits for its members. The SDCERS Board contracts with an actuary to perform an annual actuarial valuation based on the assumptions adopted by the SDCERS Board. The actuarial firm, Cheiron Inc., was hired by the SDCERS board to perform the fiscal years 2005, 2006, and 2007 actuarial valuations.

Following the most widely used actuarial cost method approved in Statement No. 25 of the Governmental Accounting Standards Board, as well as a recommendation from Cheiron, SDCERS Board of Administration voted to use the Entry Age Normal (EAN) actuarial cost method to calculate future actuarial liabilities beginning with the fiscal year 2007 valuation. The actuarial valuations performed by Cheiron, using the EAN actuarial cost method, for the fiscal years ended June 30, 2007 and June 30, 2006 reported as follows:

San Diego City Employees' Retirement System (City of San Diego)

	Fiscal Year Ended		
	June 30, 2007	June 30, 2006	% Change
<u>Membership</u>			
Total Members (active, disabled, beneficiaries and retired)	17,779	17,647	0.7%
<u>Assets and Liabilities</u>			
Total Actuarial Liability	\$ 5,597,652,861	\$ 5,191,961,325	7.8%
Market Value of Assets	4,641,340,923	3,981,931,694	16.6%
Actuarial Value of Assets	4,413,410,812	3,981,931,694	10.8%
Unfunded Actuarial Liability	\$ 1,184,242,049	\$ 1,210,029,631	-2.1%
Funding Ratio	78.8%	76.7%	2.1%

The actuarial valuations performed for SDCERS for the fiscal years 1992 through 2006 calculated actuarial liabilities in accordance with the Projected Unit Credit (PUC) actuarial cost method. The change from PUC to EAN has negatively impacted the unfunded actuarial liability reported in the actuarial valuation for the fiscal year ended June 30, 2007. A comparison of the two valuation methods for the fiscal year ended June 30, 2007 was included in the June 30, 2007 actuarial valuation and is provided below for informational purposes only:

Unfunded Actuarial Liability Projected Unit Credit (PUC) vs. Entry Age Normal (EAN) For the Fiscal Year Ended June 30, 2007			
	PUC	EAN	% Change
Actuarial Value of Liability (Cheiron*)	\$ 5,345,495,550	\$ 5,597,652,861	4.7%
Actuarial Value of Assets (Cheiron*)	4,413,410,812	4,413,410,812	0.0%
Unfunded Actuarial Liability	932,084,738	1,184,242,049	27.1%
Funding Ratio	82.6%	78.8%	-3.8%

\*SDCERS Actuary

The implementation of the EAN method resulted in an increase in the UAAL of approximately \$252.2 million and an annual required contribution of \$161.7 million payable in fiscal year 2009. The following schedule shows the effect, as of June 30, 2007, of the specific components of the total change of the Unfunded Actuarial Accrued Liability between fiscal years 2006 and 2007:

**SDCERS - City of San Diego**  
**Source of Changes in Unfunded Actuarial Accrued Liability**  
(In Millions)

<u>UAAL Change Due to Experience Factors</u>	
1. Investment experience	\$ (74.9)
2. Purchased service credits paid for during the year	1.5
3. Liability experience	38.2
<u>UAAL Change Due to Contribution Factors</u>	
4. Contributions paid in excess of expected	(20.4)
<u>UAAL Change Due to Actuarial Method Changes</u>	
5. Removal of liabilities in excess of IRC § 415 limits - Non Drop members	(3.7)
6. Removal of liabilities in excess of IRC § 415 limits - Drop members	(2.7)
7. Change in actuarial funding method to EAN	252.2
<u>Total</u>	
8. Total net overall change: sum 1 through 7	190.2
9. Expected change in UAAL	(6.7)
10. Total change in UAAL: 8 + 9	<u>\$ 183.5</u>

The benefits awarded to some plan participants exceed the amount permitted for Internal Revenue Code (IRC) 401(a) pension plans such as SDCERS. In March 2001, the San Diego City Council established a Preservation of Benefit Plan to pay for benefits in excess of those allowed under the 401(a) plan. The Preservation of Benefit Plan is a qualified governmental excess benefit arrangement (QEBA) under IRC § 415(m), which is a vehicle created by Congress to allow the payment of promised pension benefits that exceed the IRC § 415(b) limits (and therefore cannot be paid from a qualified retirement plan). The Preservation of Benefit Plan is administered by the SDCERS Board separately from the City's 401(a) pension plan. On February 16, 2007, the SDCERS Board adopted the Preservation of Benefit Plan and Trust to carry out the intent of SDMC § 24.1601 et seq.

As background, IRC § 415(b) imposes dollar limits on the benefits payable from a qualified pension plan that receive favorable tax treatment. The maximum dollar limit is \$185,000 for calendar year 2008; however, this limit is adjusted downward based upon the payee's age at retirement in addition to other factors.

The Preservation of Benefit Plan is unfunded within the meaning of the federal tax laws. Under the Internal Revenue Code the City may not pre-fund the Preservation of Benefit Plan to cover future liabilities beyond the current year, as with the 401(a) plan. Each year, SDCERS will determine the amount necessary to fund any pension benefits payable during the calendar year in excess of IRC § 415(b). This amount will include the projected amount of all excess pension benefits payable for the calendar year to existing and projected payees, as well as the projected cost of administering the Preservation of Benefit Plan. SDCERS will provide this information to the City and the City will fund this amount on an annual basis.

The estimated actuarially accrued liability related to excess benefits for eligible active members of the system, amounting to approximately \$22.8 million, has been excluded from the actuarial valuation of the 401(a) retirement plan in the fiscal year 2006 actuarial valuation. The amount related to excess benefits for eligible active members was reported to be approximately \$30.4 million in the fiscal year 2007 actuarial valuation. Additionally, the actuarial liability for retired members of the Preservation of Benefit Plan, amounting to approximately \$6.4 million, has been excluded from the fiscal year 2007 actuarial valuation of the 401(a) retirement plan (as shown in the table above). Accordingly, the actuarial liability related to retired members is reflected in the actuarial liabilities of the 401(a) plan in the actuarial valuation dated June 30, 2006 as well as in the ARC payable in fiscal year 2008.

In fiscal year 2006, activities related to the Preservation of Benefit Plan for both retired and active members are included in the actuarial liabilities presented in the Required Supplementary Information (RSI) for the City's core pension plan and are valued using the same set of assumptions. The City is in the process of implementing a plan to account for the QEBA with SDCERS.

In light of various concerns raised in investigative reports regarding practices of SDCERS that could have jeopardized its status as a qualified governmental defined benefit plan, SDCERS requested its outside tax counsel, Ice Miller LLP, to perform a comprehensive document compliance review, prepare submissions in accordance with the IRS Voluntary Correction Program (VCP), and work with the IRS to finalize a compliance statement to resolve SDCERS' compliance issues. A comprehensive settlement was reached between the IRS and SDCERS on December 20, 2007 (Settlement). The Settlement requires the City and SDCERS to take certain corrective actions regarding certain provisions of its retirement plan within 150 days of December 20, 2007. The Settlement does not require the City to pay any penalty payments or to make any additional contributions to the retirement system. In the event the City does not successfully implement certain plan document changes required by the IRS Compliance Statement, SDCERS and the City may face additional regulatory actions from the IRS including but not limited to, SDCERS plan disqualification and financial penalties against the City, the plan sponsor. Additionally, SDCERS received a favorable Determination Letter from the IRS, dated January 25, 2008, which confirms the system's tax qualified status. The Determination Letter is contingent, however, upon the San Diego City Council's adoption of an IRS-approved Technical Ordinance which would amend the Municipal Code to comply with current tax law. This ordinance must be adopted by April 25, 2008.

The VCP filings identified violations and proposed corrections regarding the City's Presidential Leave Program for presidents of certain labor organizations that represent City employees; compensation limits under IRC § 401(a)(17); minimum distribution requirements under IRC § 401(a)(9); eligible rollover distribution compliance under IRC § 401(a)(31); minimum distribution requirements from the Deferred Retirement Option Plan (DROP) program; overpayment of disability benefits; conversion of annual leave to purchased service credits; retiree healthcare benefits and health administrative expenses under IRC § 401(h); benefit and compensation limits under IRC §§ 415(b), 415(c) and 415(n); and remedial plan amendments. Readers are encouraged to review the detailed discussion of the Voluntary Compliance Program filing and the resulting settlement as contained within Note 18: Contingencies of the Basic Financial Statements.

It is the City Attorney's opinion that these excess retirement benefits require voter approval as such benefits represent a distinct

pension plan. Therefore it is also his opinion that the excess retirement benefits are illegal and that the City should discontinue payment. Other members of management believe that this issue has yet to be resolved, and as such, the City intends to continue to treat these benefits as legal obligations until instructed to do otherwise by a court. In the opinion of other management, a decision to terminate such benefits would expose the City's residents to unnecessary and costly legal fees.

Certain other methodology changes were implemented for the June 30, 2006 valuation, which are discussed in detail in the valuation report. Additional information on the City's net pension obligation and annually required contribution is discussed in Note 12 of the notes to the financial statements contained in the financial section of the CAFR and in the Required Supplementary Information section of the report.

On November 2, 2004, the public approved an amendment to Article 9, Sections 143 and 144 of the City's Charter regarding the retirement systems actuarial assumptions and the governance structure of SDCERS. Notable changes include:

- Effective fiscal year 2009, UAAL shall be amortized using a 15 year assumption (see discussion below); for the 2006 actuarial valuation, Unfunded Actuarial Accrued Liabilities were amortized over 27 years reflecting the resetting of the amortization period pursuant to the settlement of the Gleason v. City of San Diego lawsuit. (The effects of this lawsuit on the pension system are disclosed in Note 12).
- Effective fiscal year 2009, new retirement benefits shall be amortized using a schedule no longer than 5 years.
- Effective April 2005 the composition of the SDCERS Board was changed to the following:
  - 7 members appointed by the Mayor, who are not associated with the City or Retirement system as employees, union members or beneficiaries,
  - 1 member who is an active employee in the police safety group, elected by the members of that group,
  - 1 member who is an active employee in the fire safety group, elected by the members of that group,
  - 2 members who are active employees in the general member group, elected by members of that group,
  - 1 member who is a retired member of the system and is elected by the retired members of the system, and
  - 1 member who is a City management employee and serves at the pleasure of the Mayor. This member must be the Chief Operating Officer, City Treasurer, Deputy or Assistant Chief Operating Officer or a similar position that reports to the Chief Operating Officer or Mayor. As of the issuance of this report, the Deputy Chief of the Office of Ethics and Integrity is assuming the responsibility of this position.

Various concerns have been raised by City management in response to the aforementioned charter revision pertaining to the 15 year amortization assumption of the UAAL. California State Attorney General Opinion 04-710 concludes that a city charter cannot mandate a specified amortization schedule for retirement benefits or accumulated actuarial gains and losses. Furthermore, a recent legal ruling by the California Superior Court concluded that SDCERS Board has "plenary authority" over the retirement system in its administrative capacity. In March 2007, the SDCERS Board adopted a 20 year amortization assumption, with no negative amortization. The SDCERS Board did not change the amortization period to a 15 year amortization assumption for the purpose of determining the City's fiscal year 2009 Annually Required Contribution. The San Diego City Attorney's Office has opined that the voter's amendment to the Charter to establish a 15-year amortization requirement for accumulated actuarial losses simply establishes an upper boundary for the amortization of pension debt, and does not usurp or unduly interfere with the SDCERS Board's plenary authority and fiduciary responsibility in violation of the California constitution, and as a result, the 15 year amortization period is binding. Other management notes that Governmental Accounting Standards expressly state that "a plan and its employers should apply the same actuarial methods and assumptions in determining similar or related information included in their respective financial reports." However, the GASB does not assign responsibility for determining actuarial assumptions to either the plan administrator or the plan sponsor. Accordingly, the City intends to pay the full ARC as calculated by SDCERS' actuary. Given the size of the City's current Unfunded Actuarially Accrued Liability, a change to a 15-year amortization schedule could have a significant impact on future annually required contributions. In relation to the implementation of a 15-year amortization, SDCERS issued a report titled "Summary and Answers to Frequently-Asked Questions about the June 30, 2006 Actuarial Valuation for the City of San Diego." This document stated that if a 15-year amortization of the unfunded actuarial liability was implemented, the City's Annual Required Contribution for fiscal year 2008 would increase by \$29.1 million over the requested contribution of \$137.7 million. Thus, a 15-year amortization period would result in an Annual Required Contribution of \$166.8 million. Comparatively, the City's fiscal year 2008 budget included appropriations for a contribution of \$165 million to SDCERS. Additionally, SDCERS estimates that the City's ARC for fiscal year 2009 would have increased by approximately \$7 million if a 15 year amortization assumption were used.

On November 7, 2006, the public approved an amendment to Article 9, §143 of the City's Charter, requiring voter approval of certain increases in retirement system benefits for public employees. Specifically, this amendment requires voter approval of any ordinance that amends the City's retirement system by increasing the benefits of any employee. However, increases in retirement benefits due to cost of living adjustments do not require voter approval.

On August 3, 2007, the General Counsel of SDCERS issued a letter to the City stating their opinion in regards to the effective date of the fiscal year 2005 agreements between the City and the labor unions. As part of the agreements, several benefits were altered or eliminated for employees hired on or after July 1, 2005, including the Deferred Retirement Option Plan (DROP), the 13th Check, and the option to purchase years of service credits ("air-time"). According to their fiduciary counsel, "SDCERS is obligated to administer benefits in accordance with its plan documents." However, the City did not enact such ordinances until January 17, 2007, which took effect on February 16, 2007. Therefore, the General Counsel of SDCERS and their outside counsel opine that the effective date of the agreements with the labor unions is February 16, 2007, the date that the benefit changes were codified into the plan document. On October 9, 2007, the City filed a petition for declaratory relief to determine the effective date of retirement benefit changes for employees hired between July 1, 2005 and February 16, 2007.

On September 21, 2007 the President of the SDCERS Board of Administration issued a press release stating that, under the direction of the Board of Administration, SDCERS' staff, actuary, and legal counsel, he had reviewed the SDCERS purchase of service credit program, and that his review concluded the following:

- With respect to SDCERS' service credit pricing structure that was in place prior to November 2003, Cheiron, SDCERS actuary, has determined that the full cost was not reflected in the price then charged to SDCERS members.
- This pricing shortfall, which totals approximately \$146 million, has been included in the System's Unfunded Actuarial Liability since the inception of the service credit program.
- With respect to the SDCERS' service credit pricing in place since November 2003, Cheiron advised SDCERS that structure covers the full projected cost to the System when members purchased the service credits.

The pricing shortfall of approximately \$146 million, which is included in the System's Unfunded Actuarial Liability, is reported in the RSI of these financial statements.

Additionally, as a result of the City's negotiations with employee labor unions, the MOUs for the fiscal year 2006 contain agreements to either reduce the amount of individual employees' pension contributions which are paid for by the City or to impose salary reductions. The agreements explicitly state that savings to the City must be used to pay down its Unfunded Actuarial Accrued Liability (UAAL) within the timeframe of the respective contracts. The labor contract with the American Federation of State and County Municipal Employees (AFSCME) Local 127 states that "By June 30, 2008, if the City has not dedicated a total of \$600 million or more to the UAAL reduction, including the amount received by leveraging employee salary reduction and pension contribution monies, the AFSCME salary reduction monies with interest will revert to SDCERS Employee Contribution Rate Reserve for benefit of Local 127 unit members to defray employee pension contributions." The City will be excused from meeting the above obligation if the funded ratio reaches 100% by June 30, 2008.

In June 2006, the City leveraged a portion of the employee pick up savings by contributing \$90.8 million from securitization of future tobacco settlement revenues, \$9.2 million of current tobacco settlement revenues, and \$8.3 million from the remaining balance in the employee "pick-up" amount as part of meeting its negotiated commitment. In June 2007, the City contributed approximately \$7.0 million, in addition to the ARC, from the savings of the employee "pick-up" reduction. A financing option to generate \$70 to \$80 million in additional funding is currently being pursued. As of issuance of this report, it appears the City will not be able to meet the outstanding commitment by June 30, 2008 in its entirety. As such, the salary reduction monies, with interest, will likely revert to the employee contribution rate reserve as stated in the MOU with the Local 127 bargaining unit.

Additional information regarding the City's pension trust fund, including the City's NPO, can be found in Note 12 of the notes to the financial statements.

### **Other Post Employment Benefits**

#### Retiree Health

The City provides certain healthcare insurance benefits to a variety of retired employees, as provided for in SDMC Sections 24.1201 through 24.1204 (the "Plan"). Currently, the benefits are primarily for employees who were actively employed on or after October 5, 1980 and were otherwise entitled to retirement allowances. Employees who retired or terminated prior to October 6, 1980, who were eligible for retirement allowances prior to that date, are also eligible for healthcare benefits, limited to a total of \$1,200 per year. Additionally, employees who were hired on or after July 1, 2005 and become eligible for retirement allowances in the future are also eligible for healthcare benefits, limited to a total of \$1,200 per year.

Historically, the City paid for post employment healthcare benefits on a pay-as-you-go basis for retirees who received either City paid insurance or were reimbursed for other health insurance costs incurred. The total annualized cost of retiree health benefits included costs incurred for dependent healthcare, which were deducted from retiree allowances. In fiscal years 2006 and 2007,



the annualized cost of retiree health benefits was approximately \$24.1 million and \$27.1 million, respectively. The City's obligation of this cost was \$17.7 million and \$20.4 million, respectively.

The following schedule details payments for retirement health benefits:

<u>Retiree Health Care Costs</u> (in thousands)					
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006<sup>1</sup></u>	<u>2007</u>
Expenditures Paid Directly from City	\$ -	\$ -	\$ 6,949	\$ 17,696	\$ 20,419
Expenditures Paid from 401(h) reserve	11,450	12,829	7,910	-	-
Expenditures Paid by Retirees	2,981	5,458	5,978	6,374	6,727
Total Retiree Health Expenditures	<u>\$ 14,431</u>	<u>\$ 18,287</u>	<u>\$ 20,837</u>	<u>\$ 24,070</u>	<u>\$ 27,146</u>

<sup>1</sup> Expenditures paid directly from City in fiscal year 2006 includes approximately \$265 of accrued expenses.

In July 2004, GASB issued Statement No. 45, "Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions" ("GASB 45"), which addresses how local governments should account for and report their costs and obligations related to other post employment benefits (OPEB). This statement is effective for the City for periods beginning after December 15, 2006 (i.e. beginning in fiscal year 2008). GASB 45 establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities, note disclosures, and, if applicable, required supplementary information in the financial statements. In response to the requirements of GASB 45, the City Council authorized the City to enter into an agreement with CalPers to pre-fund post employment healthcare benefits on January 18, 2008. As a result, the City contributed approximately \$30.1 million to CalPers, which will be reflected in the fiscal year 2008 financial statements. The City is required to annually pre-fund the plan in an amount not less than \$5,000; however, the City intends to contribute an annual amount not less than 50% of the annual Required Contribution, as calculated by an actuary of the City's choice. All future contributions for post employment healthcare benefits will be placed in this fund and credited toward the City's annually required contribution for Retiree Healthcare liabilities in accordance with GASB 45.

An actuarial valuation of the City's postretirement medical benefit program as of June 30, 2007 was performed for the purpose of determining its annual cost in accordance with GASB 45. During fiscal year 2007, the City continued a "pay as you go" approach to funding retiree health costs. Specifically, for valuation purposes, the City used a 5% earnings assumption, an inflation factor of 3%, and a 30 year amortization period. The actuarial valuation for the fiscal year 2007 uses a 7.75% earnings assumption which is applicable only if the City intends to fully fund the ARC. However, the City intends to partially fund the ARC, and therefore, the actuarial valuation also uses a lower blended earnings assumption based on the City's actual contributions. The following table presents the actuarial accrued liability for all retirees, deferred retirement participants, vested terminated and active members, and the annual required contribution for fiscal year 2009 (as reported in the actuarial valuation dated June 30, 2007), using either of the assumptions discussed above, following the implementation of GASB 45:

<u>Retiree Healthcare Liabilities</u>		
	<u>Full Funding Method (7.75%)</u>	<u>Partial Funding Method (Blended)</u>
Actuarial Accrued Liability	\$ 819,900,461	\$ 961,630,144
Annual Required Contribution	85,091,889	95,518,668

#### Defined Contribution Plan

The City has established the Supplemental Pension Savings Plan ("SPSP"), a defined contribution plan administered by Wachovia Corporation, which provides pension benefits for eligible employees. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Eligible employees may participate from the date of employment and contributions from employer's match vest at a rate of 20% for each year of service. The City also established a 401(k) Plan effective July 1, 1985. The plan is a defined contribution plan also administered by Wachovia Corporation, to provide pension benefits for all eligible employees. Employees participating in the 401(k) plan are immediately 100% vested.

Deferred Compensation Plan

In addition to the defined benefit and contribution plans, the City also offers its employees a deferred compensation plan created in accordance with Internal Revenue Code §457. The plan, available to all eligible City employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, disability, or an unforeseeable emergency.

Additional information on the City of San Diego's pension activity may be found in Notes 12 and 13 of the notes to the financial statements.

**Long-Term Financial Outlook**

On January 11, 2008, the City released a Five-Year Financial Outlook covering fiscal years 2009 through 2013. This document is an examination of the City's long range fiscal condition and financial challenges. The City intends to update the Five-Year Outlook periodically to account for changed circumstances. In addition to other issues, the Financial Outlook concentrates on eight significant areas that must be addressed in order to restore and preserve the fiscal integrity and/or meet the legal obligations of the City. These eight significant areas are identified below:

1. Funding the City's Pension Plan.
2. Funding the City's General Fund reserves.
3. Funding deferred maintenance and capital improvement needs.
4. Funding the City's Post Employment Medical Program.
5. Funding the City's new obligations under Storm Water Runoff Permits.
6. Funding the City's Americans with Disabilities Act (ADA) obligations.
7. Funding the City's Workers' Compensation Fund.
8. Funding the City's Public Liability Fund.

The Financial Outlook relies on several assumptions, including revenue and expenditure growth estimates, to identify priorities to address in City Budgets over a five year period and assumes a significant financial commitment toward funding the aforementioned eight areas. As part of that commitment, the Outlook projected a \$32 million operating deficit for the fiscal year ended June 30, 2009. For fiscal years 2010-2013, the deficit is projected to be \$66 million, \$85 million, \$76 million, and \$50 million, respectively, before including the effect of a balanced budget in fiscal year 2009.

In order to address the projected operating deficits, the outlook discusses several potential corrective actions; however, these corrective actions are contingent on future events and City Council actions, and as such, the Financial Outlook does not reflect a binding commitment of the City. The extent to which these corrective actions will mitigate future operating deficits as identified in the Financial Outlook is unknown at the time of issuance of this report. However, the City Council approved the Fiscal Year 2008 Appropriation Ordinance on July 30, 2007 implementing the fiscal year 2008 budget which included several initiatives proposed by the Mayor in the Financial Outlook. Specifically, the Appropriations Ordinance reflected a balanced budget and the City's commitment to funding pension and other post employment healthcare liabilities.

The 2008 Budget also included appropriations for the City's full Annually Required Contribution of \$137.7 million to the City's Pension plan plus \$27.3 million in additional contributions. Amounts contributed in addition to the Annually Required Contribution will be credited to the City's NPO and UAAL.

In addition to the funding of pension and other post employment healthcare expenses, the City's 2008 budget included:

- An additional \$18 million for compliance with Storm Water Permits.
- An additional \$13.6 million for deferred maintenance and \$25 million for financed capital projects.
- An additional \$10 million for Americans with Disabilities Act Compliance.
- An additional \$5 million in funding for Public Liability Reserves.
- A budgeted reserve contribution of \$3.3 million.

Funding requirements for Workers' Compensation are planned to be addressed in fiscal year 2009, as discussed in the Five Year Financial Outlook, and were not addressed in the Fiscal Year 2008 Budget. In addition to the allocation of funds in the Fiscal Year 2008 Budget, the City Charter was recently amended to enable the City to contract for certain services, allowing a "Managed Competition" plan to be undertaken by the City. Managed Competition involves undertaking a review and redesign of how City services are delivered, with a goal of increasing the efficiency of City operations. Once completed and operating

segments have achieved the efficiency gains identified in the first step of the Managed Competition plan, operating segments are competed against private sector suppliers in an effort to determine the lowest cost approach to service delivery. If private sector suppliers are the lowest bidder, the services will be outsourced. The potential savings from Managed Competition and the effect on the projected deficits cannot be determined at this time.

Due to the City's restraint in hiring in Fiscal Year 2007, the City realized significant budgetary savings for personnel expenditures of approximately \$34.6 million for the year ended June 30, 2007. The Fiscal Year 2008 budget process identified and eliminated approximately 630 (629.71) budgeted positions citywide.

The City's Five-Year Financial Outlook discussed above can be obtained at the Financial Management Office, 202 C Street, MS8A, San Diego, CA 92101.

## **OTHER FINANCIAL INFORMATION**

### **Independent Audits**

The City Charter requires an annual audit by independent certified public accountants. The goal of an independent audit is to provide reasonable assurance that the financial statements are free of material misstatements. An independent audit involves examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by the City; and evaluating the overall financial statement presentation. In addition, the City is required to undergo an annual Single Audit in conformity with the U.S. Office of Management and Budget Circular A-133, "Audits of State and Local Governments and Non-Profit Organizations." As part of the City's Single Audit, tests are performed on internal control activities, including that portion related to federal award programs, to determine the City's compliance with applicable laws, regulations, contracts and grants.

The Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards for the fiscal year ended June 30, 2005, dated October 26, 2007, reported three material weaknesses to the internal control framework which require significant improvements in order to produce timely and accurate financial statements in a cost effective manner. Additionally, the Independent Auditor's Report on Compliance With Requirements Applicable to Each Major Program, Internal Control Over Compliance and the Schedules of Expenditures of Federal Awards and Governor's Office of Emergency Services Grants in Accordance With OMB Circular A-133 for the fiscal year ended June 30, 2005 reported compliance, in all material respects, with the requirements that are applicable to each of its major federal programs with the exception of four specific instances. City management is currently in the process of improving the internal controls over compliance in response to these issues. Both the CAFR and the Internal Auditor's Annual Reports on Internal Controls can be obtained at the City of San Diego Comptroller's Office, 202 C Street, MS6A, San Diego, CA 92101.

### **Cash Management**

The City Treasurer is responsible for investment of the City's cash. Eligible investments include, but are not limited to, obligations of the U.S. Treasury and U.S. Agencies, demand deposits, negotiable certificates of deposit, bankers' acceptances, medium-term corporate notes, repurchase agreements, and commercial paper in compliance with Sections 53601-53635 of the California Government Code. The City's cash is invested under a pooled money concept, with maturities planned to coincide with projected needs, and with the primary objective of preserving principal. During fiscal year 2006, the average daily pooled portfolio balance was approximately \$1.26 billion, with a weighted average maturity of 502 days. Most of these monies are held in funds that have restricted uses. The largest balances, for instance, are found in the utility funds. The average earned income yield on pooled investments was 3.40%, as compared to 2.07% in the prior year.

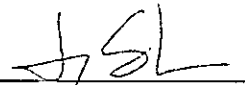
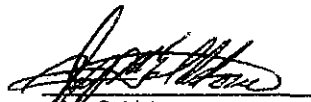
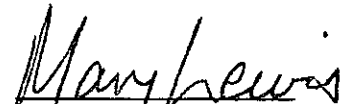
The City Treasurer's Investment Policy has an objective to minimize credit and market risks while maintaining a competitive yield on its portfolio. All non-negotiable time certificates of deposit and demand accounts in excess of the amounts insured by the Federal Deposit Insurance Corporation are required to be fully collateralized with mortgages or eligible securities in accordance with California State law. The City's investments are held by the City's custodian bank in the City's name, or the nominee name of the custodian bank, to ensure fluid and efficient processing of security trades.

Additional information on the City of San Diego's cash management activity may be found in Note 3 of the notes to the financial statements.

**Risk Management**

The City is exposed to various risks of loss related to torts: theft of, damage to, and destruction of assets; injuries to employees; and natural disasters. The City has established various self-insurance programs and maintains contracts with various insurance companies to manage excessive risk. Additional information on the City of San Diego's risk activity may be found in Notes 15 and 16 of the notes to the basic financial statements.

Sincerely,

  
Jerry Sanders  
Mayor  
Jay Goldstone  
Chief Operating Officer  
Mary Lewis  
Chief Financial Officer

City of San Diego Officials  
As of June 30, 2006

Mayor and Council Members

Jerry Sanders, Mayor

Scott Peters, Councilmember District 1

Kevin Faulconer, Councilmember District 2

Toni Atkins, Councilmember District 3

Tony Young, Councilmember District 4

Brian Maienschein, Councilmember District 5

Donna Frye, Councilmember District 6

Jim Madaffer, Councilmember District 7

Ben Hueso, Councilmember District 8

City Attorney

Michael J. Aguirre

City Officials

Ronne Froman\*, Chief Operating Officer

Jay M. Goldstone, Chief Financial Officer

John Torell\*, Auditor and Comptroller

Gail Granewich, Treasurer

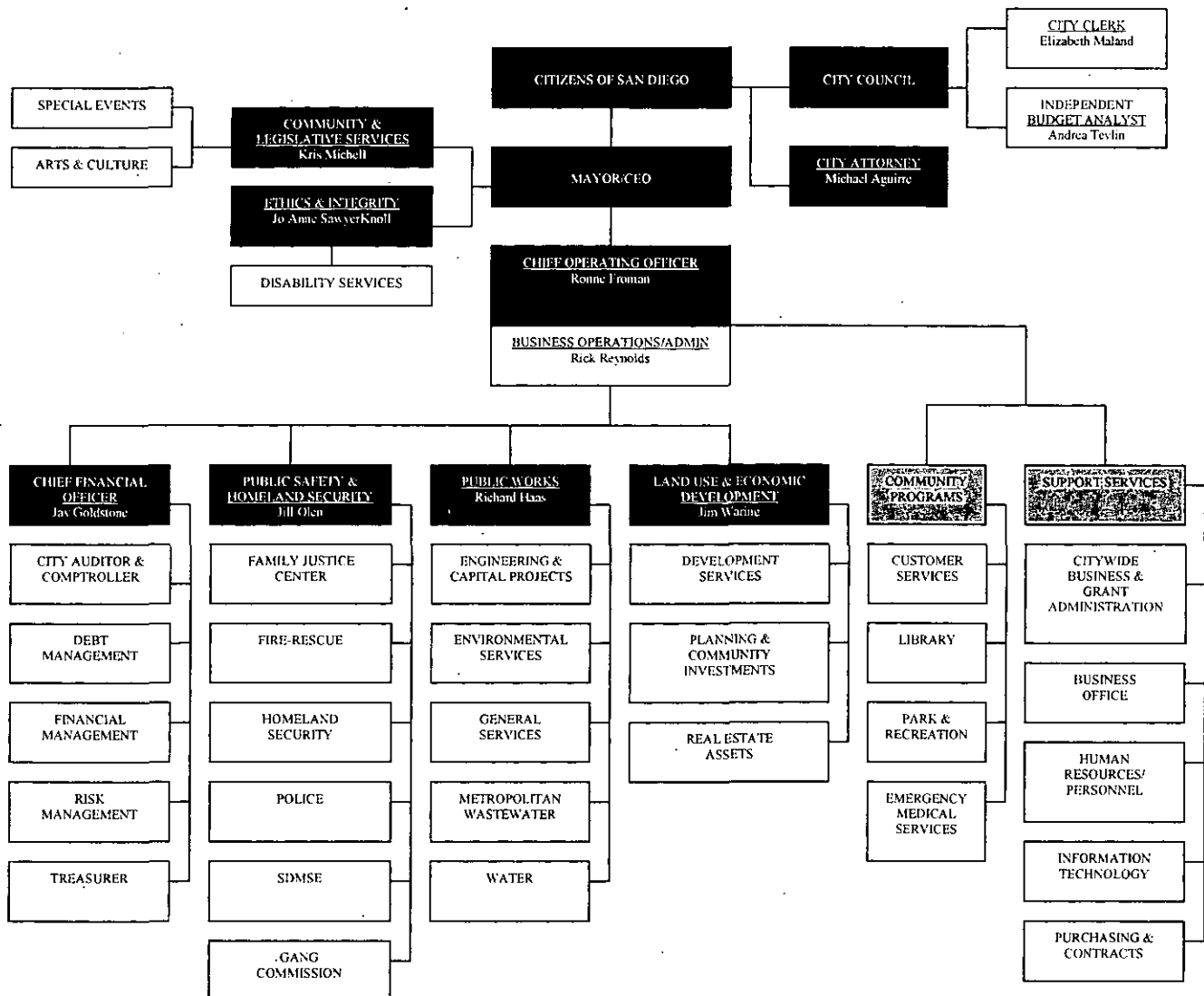
Elizabeth Maland, City Clerk

Andrea Tevlin, Independent Budget Analyst

\* Individual is no longer an employee of the City.

## City of San Diego Organization Chart

As of June 30, 2006



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FINANCIAL SECTION

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**MACIAS GINI & O'CONNELL LLP**  
CERTIFIED PUBLIC ACCOUNTANTS & MANAGEMENT CONSULTANTS

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925.274.0190

515 S. Figueroa Street, Suite 325  
Los Angeles, CA 90071  
213.286.6400

402 West Broadway, Suite 400  
San Diego, CA 92101  
619.573.1112

## Independent Auditor's Report

To the Honorable Mayor and Members of the City Council  
of the City of San Diego, California

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of San Diego, California (City), as of and for the year ended June 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the San Diego Housing Commission, a discretely presented component unit, which statements reflect 89%, 95% and 84% of total assets, total net assets and total revenues, respectively, of the aggregate discretely presented component unit totals. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the San Diego Housing Commission, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the San Diego Convention Center Corporation were not audited in accordance with *Government Auditing Standards*. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City as of June 30, 2006, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 21, 2008 on our consideration of the City's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be considered in assessing the results of our audit.

The management's discussion and analysis, analysis of funding progress and general fund budgetary information on pages 33 through 45, 154 and 155 through 160, respectively, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City's basic financial statements. The introductory section, supplementary information, and statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The supplementary information, except for the budgetary schedules on pages 206 through 213, 216 through 217 and 227, have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory section and statistical section have not been subjected to the auditing procedures applied by us in the audit of the basic financial statements and, accordingly, we express no opinion on them.

*Macias Fini & O'Connell LLP*

Certified Public Accountants

Los Angeles, California  
March 21, 2008.

**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**(Unaudited)**  
**(In Thousands)**  
**June 30, 2006**

As management of the City of San Diego (City), we offer readers of the City financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2006.

**OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements are comprised of three components: (1) government-wide financial statements; (2) fund financial statements; and (3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

**GOVERNMENT-WIDE FINANCIAL STATEMENTS**

The government-wide financial statements are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The statement of net assets presents information on all of the City's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The statement of activities presents information showing changes in the City's net assets during the fiscal year 2006. All changes in net assets are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. The focus is on both gross and net costs of City functions, which are supported by general revenues. This Statement also distinguishes functions of the City that are principally supported by taxes and intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (business-type activities). The governmental activities of the City include: General Government and Support; Public Safety - Police; Public Safety - Fire and Life Safety; Parks, Recreation, Culture and Leisure; Transportation; Sanitation and Health; and Neighborhood Services. The business-type activities of the City include: Airports; City Store; Development Services; Environmental Services; Golf Course; Recycling; Sewer Utility; and Water Utility.

The government-wide financial statements include the City (known as the primary government) and the following legally separate, discretely presented component units: San Diego Convention Center Corporation (SDCCC); and San Diego Housing Commission (SDHC). Financial information for these component units is reported separately from the financial information presented for the primary government. Blended component units, also legally separate entities, are a part of the government's operations and are combined with the primary government.

Included within the primary government as blended component units:

- Centre City Development Corporation
- City of San Diego Metropolitan Transit Development Board Authority
- Community Facility and Other Special Assessment Districts
- Convention Center Expansion Financing Authority
- Public Facilities Financing Authority
- Redevelopment Agency of the City of San Diego
- San Diego City Employees' Retirement System (SDCERS)
- San Diego Data Processing Corporation
- San Diego Facilities and Equipment Leasing Corporation

- San Diego Industrial Development Authority
- San Diego Open Space Park Facilities District #1
- Southeastern Economic Development Corporation
- City of San Diego Tobacco Settlement Revenue Funding Corporation

The government-wide financial statements can be found beginning on page 50 of this report.

#### FUND FINANCIAL STATEMENTS

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

#### GOVERNMENTAL FUNDS

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The City maintains individual governmental funds. Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures, and changes in fund balances for the general fund, which is a major fund. Data from the other governmental funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor governmental funds is provided in the form of combining statements elsewhere in this report.

The City adopts an annual appropriated budget for its general fund. A budgetary comparison statement has been provided for the General Fund to demonstrate compliance with this budget and is presented as required supplementary information.

The basic governmental funds financial statements can be found beginning on page 54 of this report.

#### PROPRIETARY FUNDS

The City maintains two different types of proprietary funds, enterprise funds and internal service funds. Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements. The City uses Enterprise Funds to account for its various business-type activities. Internal Service funds, such as Central Garage and Machine Shop, Central Stores, Print Shop, and Self Insurance, are used to report activities that provide centralized supplies and services to the City. All internal service funds, except for the Special Engineering Fund, have been included within governmental activities in the government-wide financial statements since they predominantly benefit governmental functions. The Special Engineering Fund, which services exclusively Water and Sewer activities, has been included within business-type activities in the government-wide financial statements.

Proprietary fund statements provide the same type of information as the government-wide financial statements, only in more detail. The proprietary funds financial statements provide separate information for the Water and Sewer funds, which are considered to be major funds of the City. Data from other proprietary funds are combined into a single, aggregated presentation. Individual fund data for each of these nonmajor business-type funds is provided in the form of combining statements elsewhere in this report. Internal service funds are combined into a single, aggregated presentation in the proprietary funds financial statements. Individual fund data for the internal service funds is provided in the form of combining statements elsewhere in this

report. The basic proprietary funds financial statements can be found beginning on page 58 of this report.

#### **FIDUCIARY FUNDS**

Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statement because the resources of those funds are not available to support the City's programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

The basic fiduciary funds financial statements can be found beginning on page 61 of this report.

#### **NOTES TO THE FINANCIAL STATEMENTS**

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found beginning on page 63 of this report.

#### **OTHER INFORMATION**

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the City's progress in funding its obligation to provide pension benefits to its employees. Required supplementary information can be found beginning on page 154 of this report.

The combining statements referred to earlier in connection with nonmajor governmental funds, nonmajor business-type funds, internal service funds, and fiduciary funds are presented immediately following the required supplementary information on pensions and the General Fund budgetary comparison statement. Combining and individual fund statements and schedules can be found beginning on page 187 of this report.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

CITY OF SAN DIEGO'S SUMMARY OF NET ASSETS  
(In Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2006	2005*	2006	2005	2006	2005*
Capital Assets	\$ 4,307,640	\$ 4,284,409	\$ 4,536,313	\$ 4,507,385	\$ 8,843,953	\$ 8,791,794
Other Assets	1,511,124	1,337,369	650,350	647,459	2,161,474	1,984,828
Total Assets	5,818,764	5,621,778	5,186,663	5,154,844	11,005,427	10,776,622
Net Long-Term Liabilities	1,876,763	1,797,521	1,866,411	1,870,766	3,743,174	3,668,287
Other Liabilities	160,423	192,679	109,123	116,070	269,546	308,749
Total Liabilities	2,037,186	1,990,200	1,975,534	1,986,836	4,012,720	3,977,036
Net Assets:						
Invested in Capital Assets,						
Net of Related Debt	3,472,531	3,478,769	2,867,469	2,863,136	6,340,000	6,341,905
Restricted	449,173	401,486	35,085	32,929	484,258	434,415
Unrestricted	(140,126)	(248,677)	308,575	271,943	168,449	23,266
Total Net Assets	\$ 3,781,578	\$ 3,631,578	\$ 3,211,129	\$ 3,168,008	\$ 6,992,707	\$ 6,799,586

\* Certain amounts have been reclassified to conform to current year presentation

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City, assets exceeded liabilities by \$6,992,707 at June 30, 2006, an increase of \$193,121 over fiscal year 2005.

\$6,340,000, or approximately 91%, of total Net Assets represent the City's investment in capital assets (e.g., land, structures and improvements, equipment, distribution and collections systems, infrastructure, and construction-in-progress), less any outstanding debt used to acquire these assets. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves generally are not used to liquidate these liabilities.

\$484,258, or approximately 7%, of total Net Assets represent resources that are subject to external restrictions on how they may be used. The remaining balance of \$168,449, or approximately 2%, is available to finance ongoing services and obligations to the City's citizens and creditors.

Unrestricted Net Assets increased by \$145,183, primarily due to: a decrease of approximately \$46,000 in the amount of outstanding debt for governmental activities which is not capital or housing related; an increase in revenue accruals of approximately \$30,000 for In-Lieu Vehicle License Fees and grants receivable of governmental activities; an increase of \$23,000 in capital contributions related to land acquisition credits of the governmental activities; a decrease in liability claim accruals of approximately \$21,000 resulting from claims settled in fiscal year 2005 and fiscal year 2006 and a slightly lower actuarial valuation for public liability claims; and an increase in sales of water of approximately \$12,000 in the Water Utility due to rate increases.

The deficit balance of (\$140,126) in Unrestricted Net Assets for Governmental Activities reflects the fact that governmental activities raise resources based on when liabilities are expected to be paid, rather than when they are incurred. Most governments normally do not have sufficient current resources on hand to cover current and long-term liabilities. This deficit in and of itself should not be considered an economic or financial difficulty; however, it does measure how far the City has committed the government's future taxing power for purposes other than capital acquisition.

**CITY OF SAN DIEGO'S SUMMARY OF CHANGES IN NET ASSETS**  
(In Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2006	2005	2006	2005	2006	2005
<b>Revenues:</b>						
<b>Program Revenues</b>						
Charges for Current Services	\$ 278,881	\$ 268,977	\$ 705,682	\$ 697,330	\$ 984,563	\$ 966,307
Operating Grants and Contributions	101,723	109,268	1,909	2,028	103,632	111,296
Capital Grants and Contributions	100,564	134,702	77,602	63,830	178,166	198,532
<b>General Revenues</b>						
Property Taxes	459,777	381,874	-	-	459,777	381,874
Transient Occupancy Taxes	136,803	120,792	-	-	136,803	120,792
Other Local Taxes	148,001	152,577	-	-	148,001	152,577
Grants and Contributions not Restricted to						
Specific Programs	64,039	89,719	-	-	64,039	89,719
Sales Taxes	227,017	197,198	-	-	227,017	197,198
Investment Income	40,108	29,473	16,938	17,132	57,046	46,605
Other	75,943	52,979	6,502	8,815	82,445	61,794
<b>Total Revenues</b>	<b>1,632,856</b>	<b>1,537,559</b>	<b>808,633</b>	<b>789,135</b>	<b>2,441,489</b>	<b>2,326,694</b>
<b>Expenses:</b>						
General Government and Support	252,295	247,038	-	-	252,295	247,038
Public Safety-Police	370,990	372,230	-	-	370,990	372,230
Public Safety-Fire and Life Safety	194,074	186,203	-	-	194,074	186,203
Parks, Recreation, Culture and Leisure	237,375	218,601	-	-	237,375	218,601
Transportation	200,883	220,095	-	-	200,883	220,095
Sanitation and Health	48,774	45,088	-	-	48,774	45,088
Neighborhood Services	111,886	89,162	-	-	111,886	89,162
Interest on Long-Term Debt	71,109	73,381	-	-	71,109	73,381
Airports	-	-	4,100	3,196	4,100	3,196
City Store	-	-	810	808	810	808
Development Services	-	-	57,893	60,240	57,893	60,240
Environmental Services	-	-	44,493	43,711	44,493	43,711
Golf Course	-	-	9,563	8,585	9,563	8,585
Recycling	-	-	21,853	21,426	21,853	21,426
Sewer Utility	-	-	319,274	348,327	319,274	348,327
Water Utility	-	-	302,996	300,665	302,996	300,665
<b>Total Expenses</b>	<b>1,487,386</b>	<b>1,451,798</b>	<b>760,982</b>	<b>786,958</b>	<b>2,248,368</b>	<b>2,238,756</b>
<b>Change in Net Assets Before Transfers:</b>	<b>145,470</b>	<b>85,761</b>	<b>47,651</b>	<b>2,177</b>	<b>193,121</b>	<b>87,938</b>
Transfers	4,530	626	(4,530)	(626)	-	-
<b>Net Change in Net Assets</b>	<b>150,000</b>	<b>86,387</b>	<b>43,121</b>	<b>1,551</b>	<b>193,121</b>	<b>87,938</b>
Net Assets - July 1	3,631,578	3,545,191	3,168,008	3,166,457	6,799,586	6,711,648
<b>Net Assets - June 30</b>	<b>\$ 3,781,578</b>	<b>\$ 3,631,578</b>	<b>\$ 3,211,129</b>	<b>\$ 3,168,008</b>	<b>\$ 6,992,707</b>	<b>\$ 6,799,586</b>



**GOVERNMENTAL ACTIVITIES**

Governmental activities increased the City's net assets by \$150,000 during fiscal year 2006. Variances from fiscal year 2005 of more than 10% are discussed below.

- Capital Grants and Contributions decreased by \$34,138, or approximately 25%, which was caused by several factors. Donated capital assets decreased by approximately \$55,000 from fiscal year 2005. \$40,000 of this decrease was attributed to donated land, and the remaining decrease was primarily related to facilities benefit assessment (FBA) projects completed during fiscal year 2006. The Grants funds and Capital Outlay funds experienced decreases of approximately \$4,000 and \$12,000, respectively, due to departmental delays in grant billings, as well as one time grants received for property acquisitions during fiscal year 2005. These decreases were partially offset by the Redevelopment Agency's recognition of revenue that had been advanced by the San Diego Padres in prior years for the purpose of acquiring land surrounding Petco Park. The City recorded these advances as Land Acquisition Credits to be used by the developer against the sales price of the land. In fiscal year 2006, the conveyance of these parcels was completed, which increased the Capital Grants and Contributions revenue by approximately \$36,000.
- Property Tax revenue increased by \$77,903, or approximately 20%. Approximately \$23,000 was attributed to increased assessed property valuations in the Centre City Redevelopment project area, and approximately \$18,300 was due to increased In-Lieu Vehicle License Fees (VLF) received as a result of the State of California's implementation of the VLF Swaps. The remaining \$36,603 increase was attributed to increases in assessed property valuations, both in the City (approximately \$27,000) and other Redevelopment project areas (approximately \$9,600).
- Transient Occupancy Taxes increased by \$16,011, or approximately 13%, primarily due to an increase in the average daily rate charged for hotel rooms, compared to fiscal year 2005. According to the San Diego Convention & Visitors Bureau, average occupancy rates of hotels located in the San Diego area declined during calendar year 2006 by approximately 0.2%; however, average daily room rates increased by approximately 6.0%.
- Grants and Contributions not Restricted to Specific Programs decreased by \$25,680, or approximately 29%, due to the following factors. The State of California did not budget for the transfer of Booking Fees in fiscal year 2006, which resulted in a decrease of approximately \$5,000. There was also a decrease of \$20,435, due to a one time sale of VLF receivables during fiscal year 2005, by the San Diego Open Space Park Facilities District #1, which were used for a partial refunding of Open Space bonds.
- Sales Tax revenue increased by \$29,819, or approximately 15%, primarily due to \$15,000 received from the State of California pursuant to Assembly Bill 2928, during fiscal year 2006. During fiscal years 2004 and 2005, the State did not make payments to the City, and instead, made a "catch-up" payment for 2004, 2005, and 2006 during fiscal year 2006. The remainder of the increase was due to growth in taxable sales.
- Investment Income increased by \$10,635, or approximately 36%, primarily due to changes in market values.
- Other revenue increased by \$22,964, or approximately 43%. Approximately \$17,000 of this increase represents the retirement pick up amounts paid by City employees. There was also an increase of approximately \$8,600 in developer contributions within the North University City Area, to be used for various improvements including the Nobel Athletic Area.
- Neighborhood Services expense increased by \$22,724, or approximately 25%, primarily due to Redevelopment Agency losses of approximately \$8,300 on the disposition of land held for resale, for the development of low and moderate income housing in the Barrio Logan and City Heights project areas. In addition, there were increased project improvement expenditures of approximately \$5,200 related to low and moderate income housing in the Crossroads project area.

**BUSINESS-TYPE ACTIVITIES**

Business-type activities increased the City's net assets by \$43,121 during fiscal year 2006. Variances from fiscal year 2005 of more than 10% are discussed below.

- Capital Grants and Contributions increased by \$13,772, or approximately 22%, primarily due to increases in developer contributed infrastructure for Sewer and Water capital improvement projects.

- Other revenue decreased by \$2,313, or approximately 26%, primarily due to a one time claim settlement award received during fiscal year 2005 by the Sewer Utility Fund for construction defects attributed to the Rose Canyon Trunk Sewer project.
- Golf Course expense increased by \$978, or approximately 11%, primarily due to increased maintenance projects at both the Torrey Pines and Mission Bay golf courses.

## FINANCIAL ANALYSIS OF THE GOVERNMENT'S FUNDS

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

### GOVERNMENTAL FUNDS

The focus of the City's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the City's financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of fiscal year 2006, the City's governmental funds reported combined ending fund balances of \$1,137,239, an increase of \$137,625 from fiscal year 2005. Approximately \$714,932 constitutes unreserved fund balance, which is available for spending at the government's direction. The remainder of fund balance is reserved to indicate that it is not available for new spending because it has already been committed (1) to liquidate contracts and purchase orders of the period, (2) to pay debt service, (3) to generate income to pay for the perpetual funding of various programs, or (4) for a variety of other purposes.

The General Fund is the principal operating fund of the City. At the end of fiscal year 2006, undesignated fund balance of the General Fund was \$39,884, while total fund balance was \$61,641. This represents a \$593 increase from the fiscal year 2005 total fund balance.

### PROPRIETARY FUNDS

The City's proprietary fund statements provide the same type of information found in the government-wide financial statements, but in more detail.

As of the end of fiscal year 2006, Unrestricted Net Assets of the Sewer Utility Fund are \$115,603. Unrestricted Net Assets increased approximately \$6,340, or approximately 6%, mainly due to a decrease in maintenance and operations expenses of approximately \$2,900, combined with a \$3,500 decrease in debt service interest expense.

As of the end of fiscal year 2006, Unrestricted Net Assets of the Water Utility Fund are \$148,177. Unrestricted Net Assets increased by \$25,778, or approximately 21%, primarily due to a State Revolving Loan Fund addition of \$21,108, combined with an increase in the sales of water as a result of City Council approved rate increases of 6% for five years beginning July 1, 2002, through July 1, 2006.

## GENERAL FUND BUDGETARY HIGHLIGHTS

The original budget was \$28,265 lower than the final budget due to increases (decreases) in appropriations primarily attributed to the following:

- \$9,010 for General Government and Support. This increase was related to several departments. Facilities Maintenance had a \$2,482 budget increase, for services to other funds. The budget for Property Tax Administration was increased by \$1,261. Storm Water's budget increased by \$1,498 due to an increase in professional consultant services and project related costs. The City Manager's budget increased by \$690 due to the transition to the Strong Mayor form of government. The departments of Personnel, Financial Management, Engineering, and Human Resources-Organizational Effectiveness Program had a combined increase of \$1,914. This was due to the appropriation of over budget revenue which was generated by increased services. Council Administration had a budget increase of \$486 due to the addition of the Office of the Independent Budget Analyst.

- \$9,097 for Public Safety – Fire and Life Safety and Homeland Security. This increase was primarily due to personnel costs related to terminal leave payouts, specialty pay, and higher than anticipated overtime.
- \$3,187 for Neighborhood Services. This increase was primarily due to additional services provided to the Redevelopment Agency and other City funds.
- (\$8,864) for Transfers to Proprietary Funds. This decrease was the result of the reclassification of transfers to the Public Liability Fund as General Government and Support expenditures.
- \$14,888 for Transfers to Other Funds. This increase was primarily due to City Council directed transfers to Capital Projects Funds, including \$10,410 for State Route 56 right-of-way acquisition costs.

Actual revenues received for the General Fund were \$19,542 more than budgeted. Property Taxes were over budget by \$13,149, which was primarily due to higher than anticipated growth in assessed property valuations. Sales taxes were under budget by \$40,014, and In Lieu Sales Taxes were over budget by \$45,433. Both these variances were primarily a result of the State of California's implementation of the "Triple Flip." The City's 2006 budget accounted for these revenues within the Sales Tax category, however for CAFR purposes, the revenue is reported in the In Lieu Sales Tax category.

Actual expenditures for the General Fund were \$13,679 less than budgeted, primarily due to the Mayor's mandatory 5% savings plan enforced upon all General Fund departments.

## CAPITAL ASSET AND DEBT ADMINISTRATION

### CITY OF SAN DIEGO'S CAPITAL ASSETS (Net of Accumulated Depreciation) (In Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2006	2005	2006	2005	2006	2005
Land, Easements, Rights of Way	\$ 1,711,064	\$ 1,696,804	\$ 89,769	\$ 85,618	\$ 1,800,833	\$ 1,782,422
Construction-in-Progress	223,903	223,519	399,422	496,184	623,325	719,703
Structures and Improvements	785,158	765,231	1,272,150	1,217,090	2,057,308	1,982,321
Equipment	110,971	123,672	115,865	127,388	226,836	251,060
Distribution and Collection Systems	-	-	2,659,107	2,581,105	2,659,107	2,581,105
Infrastructure	1,476,544	1,475,183	-	-	1,476,544	1,475,183
Totals	<u>\$ 4,307,640</u>	<u>\$ 4,284,409</u>	<u>\$ 4,536,313</u>	<u>\$ 4,507,385</u>	<u>\$ 8,843,953</u>	<u>\$ 8,791,794</u>

## CAPITAL ASSETS

In accordance with GASB Statement No. 34, all major infrastructure assets (such as streets, signals, bridges, and drains) are capitalized by the City in the government-wide statements. While capital assets of both governmental and proprietary funds are capitalized at the government-wide level, only proprietary assets are reported at the fund level. Governmental funds will continue to be reported on a modified accrual basis at the fund level. Differences between the fund and government-wide statements

reporting for these governmental assets will be explained in both the reconciliation and the accompanying notes to the financial statements.

The City's investment in capital assets (including infrastructure) for governmental and business-type activities as of June 30, 2006 was \$8,843,953 (net of accumulated depreciation). The total increase in the City's investment in Capital Assets over fiscal year 2005 was approximately \$52,159.

#### HIGHLIGHTS OF FISCAL YEAR 2006 CAPITAL IMPROVEMENT ACTIVITIES

##### Governmental Activities

- Construction began on the Northwestern Area Station. This project will provide for the land development, design, and construction of a new Police Command and Light Vehicle Maintenance Facility. The facility will serve the Northwestern area of the City in the Carmel Valley and adjacent communities. The project is fully funded by Developer Impact Fees and Facilities Benefit Assessments. The City's fiscal year 2006 capital expenditures for this project were \$6,735.
- Right-of-way acquisition continues for the State Route 56 freeway. This project will provide for an east-west four-lane freeway between the Carmel Valley and Rancho Penasquitos communities. When complete, construction will include three separate interchanges, bike paths, and sound walls, as well as grading for the ultimate six-lane freeway. The City's fiscal year 2006 capital expenditures for this project were \$10,435.
- Construction continues on the North Torrey Pines Road Bridge. This project will provide for transitionally widening both road approaches and improving the structural integrity, functionality, and safety of the bridge. The City's fiscal year 2006 capital expenditures for this project were \$1,300.
- Construction continues on the Mira Sorrento Place project. This project will provide for widening and extending Mira Sorrento Place to a four-lane collector street. Traffic flow on Scranton Road and Vista Sorrento Parkway will improve upon project completion. The City's fiscal year 2006 capital expenditures for this project were \$2,508.
- Construction continues on Judicial Drive from Golden Haven to Eastgate Mall. This project will provide a new four lane major street and under-crossing at La Jolla Village Drive. The project is funded by the North University City Facilities Benefit Assessment. The City's fiscal year 2006 capital expenditures for this project were \$5,252.
- Construction began on the Nobel Athletic Area. Upon completion this project will provide an additional twenty-four acres of developed park land. Improvements will include a 10,300 square foot recreation center, sports fields, comfort stations, an off-leash dog area, play, and parking areas in the University City area. The City's fiscal year 2006 capital expenditures for this project were \$4,131. The project is entirely funded by the North University City Facilities Benefit Assessment.
- Construction continues on the Carmel Mountain Road - Interstate 5 Interchange project. This project provides for a diamond interchange at Interstate 5 and Carmel Mountain Road. This interchange will accommodate the increase in vehicular traffic created by development in the communities of Carmel Valley and Sorrento Hills. The City's fiscal year 2006 capital expenditures for this project were \$1,287.
- Construction continues on the Lincoln Park Fire Station #12. This project will provide for the complete reconstruction of the existing facility located at 4964 Imperial Avenue. The project is part of the Fire and Life Safety Services Facility Improvements Program. The City's fiscal year 2006 capital expenditures for this project were \$964.
- Construction continues on the North University Community Branch Library. This project will provide for the construction of a 15,000 square-foot library on a City owned park site at Nobel Drive and Judicial Drive to serve the community in North University City. The City's fiscal year 2006 capital expenditures for this project were \$2,320.
- Construction was completed on the Del Cerro Fire Station #31. This project provided for the complete reconstruction of the existing facility located at 6002 Camino Rico, in the Navajo/Del Cerro Community. The project is part of the Fire and Life Safety Services Facility Improvements Program. The City's fiscal year 2006 capital expenditures for this project were \$1,295.

- Construction continues on the Serra Mesa/Kearny Mesa Branch Library. This project will provide for the construction of a new 15,000 square-foot library on the 8900 Block of Aero Drive. Upon completion the new facility will include additional meeting rooms, computer lab, separate children's area and quiet study areas. Additional parking has also been incorporated into the design of the new facility. Serra Mesa and Kearny Mesa Developer Impact fees are the primary funding sources for this project. The City's fiscal year 2006 capital expenditures for this project were \$4,248.

#### Business-Type Activities

During fiscal year 2006 the Water Utility Fund added approximately \$46,600 in capital improvement projects (CIP). Upgrades and expansion of the Miramar Water Treatment Plant and the Alvarado Water Treatment Plant continued, along with Water Main Replacements. Capital asset write-offs for fiscal year 2006 were \$9,900, and were primarily due to losses related to abandoned projects, and retirements of developer contributed assets.

During fiscal year 2006, the Sewer Utility Fund added approximately \$19,800 in CIP, of which the Metropolitan system CIP increased approximately \$2,400 and included the Point Loma Digester S1 and S2 Upgrades. Municipal system CIP increased approximately \$17,405 and included the following major projects: Sorrento Valley Trunk Sewer Relocation, Pump Station Upgrades, and the continued replacement of sewer mains and upgrades to the sewer infrastructure. Capital asset write-offs for fiscal year 2006 were \$442, and were primarily due to retirements of developer contributed assets and equipment.

#### **HIGHLIGHTS OF APPROVED FISCAL YEAR 2007 CAPITAL IMPROVEMENT PROJECTS (CIP) BUDGET**

The Annual Approved Capital Improvements Budget for Fiscal Year 2007 is \$293,700, which is a \$95,900, or 25% decrease over the fiscal year 2006 budget of \$389,600. Engineering & Capital Projects, and Library Projects comprise 47%, and 10% of the total CIP budget, respectively. Water and Sewer projects comprise over 13% of the total CIP budget. Funding for governmental projects include TransNet funds, Facilities Benefit Assessments, Developer Impact Fees, Developer Contributions, and Federal, State, local, and private contributions. Highlights of the key budgets by department are as follows:

#### Governmental Activities

- Engineering and Capital Projects: \$140,000 (47% of total CIP budget). Key projects include the undergrounding of City utilities, which provides for underground conversion projects, to augment the California Public Utilities Commission (CPUC) Rule 20A. Funding is also allocated for conversion of City-owned street lighting and resurfacing of roadways associated with the undergrounding of utilities. The \$55,000 annual allocation for these projects is entirely funded by the Underground Surcharge Fund. Other significant projects include: \$10,500 for North Harbor Drive Navy Estuary, \$8,300 for the construction of El Camino Real, \$4,900 for Palm Avenue/I-805 Improvements, and \$3,000 for the construction of Bayshore Bikeway.
- Library: \$30,300 (10% of total CIP budget), which includes anticipated State, Federal, local, and private funding. The majority of these projects are part of the 21<sup>st</sup> Century Library System/Library Department Facility Improvements Program. Projects that are beginning design or closing out in fiscal year 2007 are related to the Mission Hills-Hillcrest, Otay Mesa/Nestor, and San Carlos Libraries. Project construction activity for fiscal year 2007 includes the Serra Mesa/Kearny Mesa Library, the North University Community Library at Nobel Park, and Phase 2 construction of the Logan Heights Library.
- Parks and Recreation: \$28,700 (9% of total CIP budget). Key budgets include: \$1,500 for the Carmel Valley Neighborhood Park, \$4,256 for Gonzales Canyon Neighborhood Park, \$5,673 for McAuliffe Community Park, and \$2,230 for Joint Use Improvements at Angier Elementary School.
- San Diego Fire-Rescue: \$9,519 (3% of total CIP budget). Key budgets include: \$6,026 for the Pacific Highlands Ranch Fire Station (#47), and \$1,500 for Black Mountain Ranch North Fire Station.

Business-Type Activities

The fiscal year 2007 Water Utility CIP budget is \$31,100, plus an additional \$22,200 for phase funded projects. Significant projects include: \$8,000 for replacing water mains citywide, \$2,200 for the Rancho Bernardo Reservoir Upgrade, and \$2,000 for the Water Department Security Upgrades.

The fiscal year 2007 Metropolitan Wastewater Department CIP budget is \$39,500. There are no phase funded projects budgeted for fiscal year 2007. Significant projects include: \$8,700 for continued sewer main replacements and upgrades to sewer infrastructure, \$12,000 for pipeline rehabilitation, and \$3,700 for improvements to Miramar Road Trunk Sewer.

## CITY OF SAN DIEGO'S OUTSTANDING DEBT

(In Thousands)

	Governmental Activities		Business-Type Activities		Total Primary Government	
	2006	2005	2006	2005	2006	2005
Capital Lease Obligations	\$ 40,541	\$ 30,647	\$ 2,051	\$ 3,521	\$ 42,592	\$ 34,168
Contracts Payable	2,615	1,715	-	-	2,615	1,715
Notes Payable	7,294	7,924	-	-	7,294	7,924
Loans Payable	14,345	5,187	91,247	63,803	105,592	68,990
Section 108 Loans	42,499	42,858	-	-	42,499	42,858
SANDAG Loans	7,355	13,979	-	-	7,355	13,979
General Obligation Bonds	12,690	14,530	-	-	12,690	14,530
Revenue Bonds/COP's/ Lease Revenue Bonds	549,850	571,285	1,662,705	1,698,060	2,212,555	2,269,345
Special Assessment/ Special Tax Bonds	133,605	137,305	-	-	133,605	137,305
Tax Allocation Bonds	514,845	415,778	-	-	514,845	415,778
Tobacco Settlement Bonds	105,400	-	-	-	105,400	-
Totals	<u>\$ 1,431,039</u>	<u>\$ 1,241,208</u>	<u>\$ 1,756,003</u>	<u>\$ 1,765,384</u>	<u>\$ 3,187,042</u>	<u>\$ 3,006,592</u>

**LONG-TERM DEBT**

At the end of fiscal year 2006, the City, including blended component units, had total debt outstanding of approximately \$3,187,042. Of this amount, \$12,690 is comprised of debt backed by the full faith and credit of the City. The remainder of the City's debt represents revenue bonds, lease revenue bonds, COPs, special assessment bonds, tax allocation bonds, contracts payable, notes payable, loans payable, Section 108 loans, capital lease obligations, and San Diego Association of Governments (SANDAG) loans.

Governmental Activities

- The City established the Tobacco Settlement Revenue Funding Corporation (TSRFC), a California Nonprofit Public Benefit Corporation to acquire future Tobacco Settlement Revenues from the City. TSRFC issued \$105,400 of Tobacco Settlement Asset-Backed Bonds, series 2006, which are limited obligations of the Corporation, payable from and secured by a pledge of the first \$10,100 annually from the tobacco settlement revenues due to the City and acquired by TSRFC.

- The City (RDA) issued \$76,225 of Subordinate Tax Allocation Bonds (series 2006A) and \$33,760 of Subordinate Housing Tax Allocation Bonds (series 2006B). The 2006A Bonds were issued for the purpose of financing redevelopment activities within the Centre City Project, and to pay for the costs of the debt service reserve surety bonds and costs of issuance. The 2006B Bonds were issued for the purpose of financing certain improvements relating to increasing the development of low and moderate income housing, to pay the costs of the debt service surety bonds and costs of issuance.
- Total principal payments for long-term debt were \$59,514, which includes \$37,893 principal payments for outstanding bonds, \$10,798 payments on loans payable, \$630 payments on notes payable, and \$10,193 principal payments on capital leases.

#### Business-Type Activities

- A Sewer loan from the State Water Resources Control Board for \$10,093 and a Water loan from the Department of Health for \$21,525 were executed in order to construct capital improvement projects.
- Total principal payments for long-term debt were \$40,999, which includes \$35,355 principal payments for outstanding bonds, \$4,174 payments on loans payable and \$1,470 principal payments on capital leases.

The following are credit ratings changes that have occurred to date since July 1, 2003, pertaining to the City of San Diego's outstanding General Obligation bonds, Revenue Bonds, Lease Revenue Bonds, and COPs:

Moody's Investor's Service							
	July 1, 2003	Feb 2, 2004	Apr 6, 2004	Aug 12, 2004	Sept 24, 2004	Dec 3, 2004	Aug 2, 2005*
General Obligation Bonds	Aa1	Aa1	Aa1	Aa3	A1	A1	A3
General Fund Backed Lease Revenue Obligations	Aa3/A1	Aa3/A1	Aa3/A1	A2/A3	A3/Baa1	A3/Baa1	Baa2/Baa3
Outlook/Watch	Stable	Negative Outlook	Watchlist for Possible Downgrade	Stable	Negative Outlook	Negative Outlook	Negative Outlook
Wastewater System Obligations	A1	A1	A1	A1	A1	A1	A3
Water System Obligations	Aa3/A1	Aa3/A1	Aa3/A1	Aa3/A1	Aa3/A1	Aa3/A1	A2/A3
Outlook/Watch	Stable	Stable	Stable	Stable	Stable	Credit Watch Negative	Negative Outlook
* - Ratings were affirmed on February 16, 2006							

Fitch Ratings					
	July 1, 2003	Feb 27, 2004	Sept 23, 2004	Feb 16, 2005	May 27, 2005
General Obligation Bonds	AAA	AA	AA	A	BBB+
General Fund Backed Lease Revenue Obligations	AA+	AA-	AA-	A-	BBB-
Outlook/Watch	Stable	Negative Outlook	Rating Watch Negative	Rating Watch Negative	Rating Watch Negative
Wastewater System Obligations	AA-	AA-	AA-	A	BBB+
Water System Obligations	AA-/A+	AA-/A+	AA-/A+	A/A-	BBB+/BBB
Outlook/Watch	Stable	Stable	Stable	Rating Watch Negative	Rating Watch Negative

Standard & Poor's			
	July 1, 2003	Feb 23, 2004	Sept 20, 2004
General Obligation Bonds	AA	AA-	Suspended
General Fund Backed Lease Revenue Obligations	AA-	A+	Suspended
Outlook/Watch	Stable	Negative Credit Watch	Negative Credit Watch
Wastewater System Obligations	A	A	Suspended
Water System Obligations	AA-/A+	AA-/A+	Suspended
Outlook/Watch	Stable	Negative Credit Watch	Negative Credit Watch

As of January 2008, the City of San Diego Tobacco Settlement Revenue Funding Corporation Tobacco Settlement Asset Backed Bonds, Series 2006, were upgraded by Fitch Ratings from BBB to BBB plus. AMBAC Assurance Corporation and FGIC Corporation bond insurance policies and surety debt reserve policies, which support ratings and certain of the City's debt obligations issued on a long term fixed rate basis, have been downgraded by Fitch Ratings from AAA to AA and to A, respectively. None of the underlying ratings, as shown in the tables above, have been changed as a result of such action.

Section 90 of the City Charter provides that the general obligation bonded indebtedness for the development, conservation and furnishings of water shall not exceed 15% of the last preceding assessed valuation of all real and personal property of the City subject to direct taxation, and that the bonded indebtedness for other municipal improvements shall not exceed 10% of such valuation. The City's current outstanding general obligation balances as of June 30, 2006 are significantly less than the current debt limitations for water and other purposes, which are \$4,724,374 and \$3,149,583, respectively (see Statistics Table 12).

It has been the City's practice, as provided for in Section 90.1 of the City Charter, to issue revenue bonds for the purpose of constructing water facilities. Per Section 90.1, revenue bonds do not constitute an indebtedness of the City, but an obligation payable from the revenues received by the utility. Section 90.2 authorizes the issuance of Revenue Bonds for the purpose of constructing improvements to the City's sewer system.

Additional information on the City's long-term debt can be found in the accompanying notes to the financial statements.

#### REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the City's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the City Auditor & Comptroller, 202 C Street, San Diego, California 92101 or e-mailed to the City Auditor and Comptroller at [auditor@sandiego.gov](mailto:auditor@sandiego.gov). This financial report is also available on the City's website at [www.sandiego.gov](http://www.sandiego.gov), under the Auditor and Comptroller department.



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## BASIC FINANCIAL STATEMENTS

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**000532**

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**STATEMENT OF NET ASSETS**  
**June 30, 2006**  
**(In Thousands)**

	Primary Government			Component Units	
	Governmental Activities	Business-Type Activities	Total	San Diego Convention Center Corporation	San Diego Housing Commission
<b>ASSETS</b>					
Cash and Investments .....	\$ 1,047,310	\$ 426,134	\$ 1,473,444	\$ 15,376	\$ 68,048
Receivables:					
Taxes - Net .....	97,769	-	97,769	-	-
Accounts - Net of Allowance for Uncollectibles					
(Governmental \$8,458, Business-Type \$1,304) .....	30,547	68,319	98,866	2,687	768
Claims - Net .....	123	-	123	-	-
Contributions .....	184	-	184	-	-
Special Assessments - Net .....	1,346	-	1,346	-	-
Facilities Benefit Assessment Credits Receivable .....	13,267	-	13,267	-	-
Notes .....	52,589	-	52,589	-	117,430
Accrued Interest .....	8,530	5,146	13,676	-	12,514
Grants .....	58,708	2,321	61,029	-	-
From Other Agencies .....	-	-	-	-	7,833
Investment in Joint Venture .....	2,063	-	2,063	-	-
Advances to Other Agencies .....	3,554	-	3,554	-	-
Internal Balances .....	(2,931)	2,931	-	-	-
Inventories of Water in Storage .....	-	26,548	26,548	-	-
Inventories .....	2,770	519	3,289	8	67
Land Held for Resale .....	32,133	-	32,133	-	-
Prepaid Expenses .....	2,084	721	2,805	1,018	744
Restricted Cash and Investments .....	136,493	106,133	242,626	-	1,206
Deferred Charges .....	24,585	11,580	36,165	-	-
Capital Assets - Non-Depreciable .....	1,934,967	489,191	2,424,158	-	40,487
Capital Assets - Depreciable .....	2,372,873	4,047,122	6,419,795	18,812	40,893
<b>TOTAL ASSETS .....</b>	<b>5,818,764</b>	<b>5,186,663</b>	<b>11,005,427</b>	<b>35,901</b>	<b>289,680</b>

**STATEMENT OF NET ASSETS**  
**June 30, 2006**  
(In Thousands)

	Primary Government			Component Units	
	Governmental Activities	Business - Type Activities	Total	San Diego Convention Center Corporation	San Diego Housing Commission
<b>LIABILITIES</b>					
Accounts Payable .....	\$ 69,999	\$ 47,206	\$ 117,205	\$ 2,071	\$ 2,591
Accrued Wages and Benefits .....	26,977	9,168	36,145	-	38
Other Accrued Liabilities .....	21	60	81	1,879	485
Interest Accrued on Long-Term Debt .....	21,766	17,889	39,655	-	38
Long-Term Debt Due Within One Year .....	123,476	73,671	197,147	2,782	1,663
Due to Other Agencies .....	1,199	12,200	13,399	-	-
Unearned Revenue .....	35,155	9,276	44,431	8,234	96
Contract Deposits .....	-	9,465	9,465	-	-
Sundry Trust Liabilities .....	3,826	-	3,826	-	-
Liabilities Payable from Restricted Assets:					
Customer Deposits Payable .....	-	3,849	3,849	-	-
Deposits/Advances from Others .....	-	30	30	-	954
Land Acquisition Credits .....	1,480	-	1,480	-	-
Long-Term Liabilities Due After One Year:					
Arbitrage Liability .....	-	193	193	-	-
Compensated Absences .....	40,756	8,810	49,566	45	-
Liability Claims .....	170,092	48,855	218,947	-	-
Capital Lease Obligations .....	31,767	1,006	32,773	2,956	-
Contracts Payable .....	2,615	-	2,615	-	-
Notes Payable .....	7,294	-	7,294	3,500	13,619
Loans Payable .....	11,643	86,570	98,213	-	-
SANDAG Loans Payable .....	2,248	-	2,248	-	-
Section 108 Loans Payable .....	39,431	-	39,431	-	-
Net Bonds Payable .....	1,289,354	1,598,101	2,887,455	-	-
Estimated Landfill Closure and Postclosure Care .....	-	14,811	14,811	-	-
Net Pension Obligation .....	158,087	38,394	196,481	-	-
<b>TOTAL LIABILITIES</b> .....	<b>2,037,186</b>	<b>1,975,534</b>	<b>4,012,720</b>	<b>21,467</b>	<b>19,484</b>
<b>NET ASSETS</b>					
Invested in Capital Assets, Net of Related Debt .....	3,472,531	2,867,469	6,340,000	8,650	67,289
Restricted for:					
Capital Projects .....	273,575	-	273,575	2,577	-
Debt Service .....	-	2,970	2,970	-	-
Low-Moderate Income Housing .....	64,493	-	64,493	-	-
Permanent Endowments:					
Nonexpendable .....	14,568	-	14,568	-	-
Other .....	96,537	32,115	128,652	-	74,995
Unrestricted .....	(140,126)	308,575	168,449	3,207	127,912
<b>TOTAL NET ASSETS</b> .....	<b>\$ 3,781,578</b>	<b>\$ 3,211,129</b>	<b>\$ 6,992,707</b>	<b>\$ 14,434</b>	<b>\$ 270,196</b>

The accompanying notes are an integral part of the financial statements.

**STATEMENT OF ACTIVITIES**  
**Year Ended June 30, 2006**  
(In Thousands)

Functions/Programs	Expenses	Charges for Services	Program Revenues	
			Operating Grants and Contributions	Capital Grants and Contributions
<b>Primary Government:</b>				
<b>Governmental Activities:</b>				
General Government and Support .....	\$ 252,295	\$ 96,345	\$ 10,581	\$ 2,874
Public Safety - Police .....	370,990	24,256	41,722	-
Public Safety - Fire and Life Safety .....	194,074	18,572	9,808	-
Parks, Recreation, Culture and Leisure .....	237,375	51,196	4,328	19,711
Transportation .....	200,883	52,375	217	22,424
Sanitation and Health .....	48,774	10,697	786	-
Neighborhood Services .....	111,886	25,440	34,281	38,449
Interest on Long-Term Debt .....	71,109	-	-	17,106
<b>TOTAL GOVERNMENTAL ACTIVITIES .....</b>	<b>1,487,386</b>	<b>278,881</b>	<b>101,723</b>	<b>100,564</b>
<b>Business-Type Activities:</b>				
Airports .....	4,100	4,385	-	1,364
City Store .....	810	837	-	-
Development Services .....	57,893	55,011	-	-
Environmental Services .....	44,493	39,850	92	-
Golf Course .....	9,563	13,119	-	-
Recycling .....	21,853	21,345	573	-
Sewer Utility .....	319,274	290,568	461	31,976
Water Utility .....	302,996	280,567	783	44,262
<b>TOTAL BUSINESS-TYPE ACTIVITIES .....</b>	<b>760,982</b>	<b>705,682</b>	<b>1,909</b>	<b>77,602</b>
<b>TOTAL PRIMARY GOVERNMENT .....</b>	<b>\$ 2,248,368</b>	<b>\$ 984,563</b>	<b>\$ 103,632</b>	<b>\$ 178,166</b>
<b>Component Units:</b>				
San Diego Convention Center Corporation .....	\$ 32,116	\$ 28,158	\$ 4,339	\$ -
San Diego Housing Commission .....	149,419	18,228	150,530	1,306
<b>TOTAL COMPONENT UNITS .....</b>	<b>\$ 181,535</b>	<b>\$ 46,386</b>	<b>\$ 154,869</b>	<b>\$ 1,306</b>
<b>General Revenues:</b>				
Property Taxes .....				
Transient Occupancy Taxes .....				
Other Local Taxes .....				
Developer Contributions and Fees .....				
Grants and Contributions not Restricted to Specific Programs .....				
Sales Taxes .....				
Investment Income .....				
Gain on Sale of Capital Assets .....				
Miscellaneous .....				
Transfers .....				
<b>TOTAL GENERAL REVENUES AND TRANSFERS .....</b>				
<b>CHANGE IN NET ASSETS .....</b>				
Net Assets at Beginning of Year .....				
<b>NET ASSETS AT END OF YEAR .....</b>				

Net Revenue/(Expense) and Changes in Net Assets				
Primary Government			Component Units	
Governmental Activities	Business-Type Activities	Total	San Diego Convention Center Corporation	San Diego Housing Commission
\$ (142,495)	\$ -	\$ (142,495)	\$ -	\$ -
(305,012)	-	(305,012)	-	-
(165,694)	-	(165,694)	-	-
(162,140)	-	(162,140)	-	-
(125,867)	-	(125,867)	-	-
(37,291)	-	(37,291)	-	-
(13,716)	-	(13,716)	-	-
(54,003)	-	(54,003)	-	-
(1,006,218)	-	(1,006,218)	-	-
-	1,649	1,649	-	-
-	27	27	-	-
-	(2,882)	(2,882)	-	-
-	(4,551)	(4,551)	-	-
-	3,556	3,556	-	-
-	65	65	-	-
-	3,731	3,731	-	-
-	22,616	22,616	-	-
-	24,211	24,211	-	-
(1,006,218)	24,211	(982,007)	-	-
-	-	-	381	-
-	-	-	-	20,645
-	-	-	381	20,645
459,777	-	459,777	-	-
136,803	-	136,803	-	-
148,001	-	148,001	-	-
53,502	-	53,502	-	-
64,039	-	64,039	-	-
227,017	-	227,017	-	-
40,108	16,938	57,046	587	5,740
1,214	-	1,214	-	12
21,227	6,502	27,729	528	-
4,530	(4,530)	-	-	-
1,156,218	18,910	1,175,128	1,115	5,752
150,000	43,121	193,121	1,496	26,397
3,631,578	3,168,008	6,799,586	12,938	243,799
\$ 3,781,578	\$ 3,211,129	\$ 6,992,707	\$ 14,434	\$ 270,196

The accompanying notes are an integral part of the financial statements.



**GOVERNMENTAL FUNDS  
BALANCE SHEET  
JUNE 30, 2006  
(In Thousands)**

	General Fund	Other Governmental Funds	Total Governmental Funds
<b>ASSETS</b>			
Cash and Investments .....	\$ 23,281	\$ 922,515	\$ 945,796
Receivables:			
Taxes - Net .....	68,568	29,201	97,769
Accounts - Net of Allowance for Uncollectibles (General Fund \$7,335, Other Governmental \$408) .....	11,239	13,984	25,203
Claims - Net .....	38	68	106
Special Assessments - Net .....	-	1,346	1,346
Notes .....	-	52,589	52,589
Accrued Interest .....	1,434	7,044	8,478
Grants .....	-	58,708	58,708
From Other Funds .....	6,060	15,364	21,424
Advances to Other Funds .....	300	4,414	4,714
Advances to Other Agencies .....	9	3,545	3,554
Land Held for Resale .....	-	32,133	32,133
Prepaid Items .....	220	232	452
Investment in Joint Venture .....	2,063	-	2,063
Restricted Cash and Investments .....	-	136,360	136,360
<b>TOTAL ASSETS .....</b>	<b>\$ 113,212</b>	<b>\$ 1,277,483</b>	<b>\$ 1,390,695</b>
<b>LIABILITIES</b>			
Accounts Payable .....	\$ 5,642	\$ 48,182	\$ 53,824
Accrued Wages and Benefits .....	22,332	1,323	23,655
Other Accrued Liabilities .....	-	21	21
Due to Other Funds .....	-	24,823	24,823
Due to Other Agencies .....	-	1,199	1,199
Unearned Revenue .....	1,032	34,018	35,050
Deferred Revenue .....	21,580	77,133	98,713
Interfund Interest Payable .....	-	773	773
Interfund Loan Payable .....	-	5,873	5,873
Advances from Other Funds .....	985	4,714	5,699
Sundry Trust Liabilities .....	-	3,826	3,826
<b>TOTAL LIABILITIES .....</b>	<b>\$ 51,571</b>	<b>\$ 201,885</b>	<b>\$ 253,456</b>

**GOVERNMENTAL FUNDS  
BALANCE SHEET  
JUNE 30, 2006  
(In Thousands)**

	<u>General Fund</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<b>FUND EQUITY:</b>			
<b>Fund Balances:</b>			
Reserved for Land Held for Resale .....	-	30,806	30,806
Reserved for Encumbrances .....	18,916	128,714	147,630
Reserved for Advances .....	309	7,959	8,268
Reserved for Low and Moderate Income Housing .....	-	96,732	96,732
Reserved for Permanent Endowments .....	-	14,568	14,568
Reserved for Debt Service .....	-	122,240	122,240
Reserved for Minority Interest in Joint Venture .....	2,083	-	2,083
<b>Unreserved, Reported in General Fund:</b>			
Designated for Subsequent Years' Expenditures .....	469	-	469
Undesignated .....	39,884	-	39,884
<b>Unreserved, Reported in:</b>			
Special Revenue Funds .....	-	267,576	267,576
Debt Service Funds .....	-	217	217
Capital Projects Funds .....	-	406,130	406,130
Permanent Funds .....	-	656	656
<b>TOTAL FUND EQUITY .....</b>	<u>61,641</u>	<u>1,075,598</u>	<u>1,137,239</u>
<b>TOTAL LIABILITIES AND FUND EQUITY .....</b>	<u>\$ 113,212</u>	<u>\$ 1,277,483</u>	

Amounts reported for governmental activities in the Statement of Net Assets are different because:

Capital assets used in governmental activities are not financial resources, and therefore, are not reported in the funds.	4,234,929
Other assets and liabilities used in governmental activities are not financial resources, and therefore, are either deferred or not reported in the funds.	135,085
Internal Service funds are used by management to charge the costs of activities such as Central Garage and Machine Shop, Print Shop, Self Insurance, and Central Stores to individual funds. The assets and liabilities of Internal Service Funds are included in governmental activities in the Statement of Net Assets.	(50,350)
Certain liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds.	<u>(1,675,325)</u>
<b>Net Assets of governmental activities</b>	<u>\$ 3,781,578</u>

The accompanying notes are an integral part of the financial statements.

**GOVERNMENTAL FUNDS**  
**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES**  
**YEAR ENDED JUNE 30, 2006**  
(In Thousands)

	General Fund	Other Governmental Funds	Total Governmental Funds
<b>REVENUES</b>			
Property Taxes .....	\$ 322,087	\$ 135,821	\$ 457,908
Special Assessments .....	-	36,699	36,699
Sales Taxes .....	110,556	116,461	227,017
In-Lieu Sales Taxes .....	45,433	-	45,433
Transient Occupancy Taxes .....	72,126	64,675	136,801
Other Local Taxes .....	72,102	75,899	148,001
Licenses and Permits .....	31,913	10,204	42,117
Fines, Forfeitures and Penalties .....	32,346	3,095	35,441
Revenue from Use of Money and Property .....	35,872	53,566	89,438
Revenue from Federal Agencies .....	3,755	39,815	43,570
Revenue from Other Agencies .....	12,594	45,695	58,289
Revenue from Private Sources .....	-	91,287	91,287
Charges for Current Services .....	91,514	35,607	127,121
Other Revenue .....	2,864	23,059	25,923
<b>TOTAL REVENUES</b> .....	<b>833,162</b>	<b>731,883</b>	<b>1,565,045</b>
<b>EXPENDITURES</b>			
Current:			
General Government and Support .....	183,143	107,407	290,550
Public Safety - Police .....	335,295	73,179	408,474
Public Safety - Fire and Life Safety .....	173,969	38,100	212,069
Parks, Recreation, Culture and Leisure .....	108,153	107,885	216,038
Transportation .....	23,032	124,945	147,977
Sanitation and Health .....	41,720	7,374	49,094
Neighborhood Services .....	19,702	92,378	112,080
Capital Projects .....	-	126,583	126,583
Debt Service:			
Principal Retirement .....	2,504	50,789	53,293
Interest .....	3,416	65,318	68,732
<b>TOTAL EXPENDITURES</b> .....	<b>890,934</b>	<b>793,956</b>	<b>1,684,890</b>
<b>EXCESS (DEFICIENCY) OF REVENUES</b>			
<b>OVER EXPENDITURES</b> .....	<b>(57,772)</b>	<b>(62,073)</b>	<b>(119,845)</b>
<b>OTHER FINANCING SOURCES (USES)</b>			
Transfers from Proprietary Funds .....	2,989	3,986	6,975
Transfers from Other Funds .....	71,672	340,453	412,125
Transfers to Proprietary Funds .....	(246)	(1,538)	(1,784)
Transfers to Other Funds .....	(21,946)	(390,179)	(412,125)
Net Income from Joint Venture .....	522	-	522
Capital Leases .....	5,374	14,713	20,087
Contracts/Notes Issued .....	-	900	900
Loans Issued .....	-	9,171	9,171
Section 108 Loans Issued .....	-	2,151	2,151
SANDAG Loans Issued .....	-	1,651	1,651
Tax Allocation Bonds Issued .....	-	109,985	109,985
Tobacco Settlement Bonds Issued .....	-	105,400	105,400
Discount on Bonds Issued .....	-	(97)	(97)
Premium on Bonds Issued .....	-	2,509	2,509
<b>TOTAL OTHER FINANCING SOURCES (USES)</b> .....	<b>58,365</b>	<b>199,105</b>	<b>257,470</b>
<b>NET CHANGE IN FUND BALANCES</b> .....	<b>593</b>	<b>137,032</b>	<b>137,625</b>
Fund Balances at Beginning of Year .....	61,048	938,566	999,614
<b>FUND BALANCES AT END OF YEAR</b> .....	<b>\$ 61,641</b>	<b>\$ 1,075,598</b>	<b>\$ 1,137,239</b>

The accompanying notes are an integral part of the financial statements.

City of San Diego  
 Reconciliation of the Statement of Revenues, Expenditures, and  
 Changes in Fund Balances of Governmental Funds  
 to the Statement of Activities  
 Year Ended June 30, 2006  
 (In Thousands)

Net change in fund balances - total governmental funds (page 56)	\$ 137,625
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.	40,817
The net effect of various miscellaneous transactions involving capital assets (i.e., donations, retirements, and transfers) is to decrease net assets.	(5,135)
Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds.	21,103
Revenues in the Statement of Activities for the reduction of land acquisition credits do not provide current financial resources and are not reported in the funds.	21,945
Revenues in the Statement of Activities for Facilities Benefit Assessment (FBA) credits earned do not provide a current financial resource and are not reported as revenues in the funds.	13,267
The issuance of long-term debt (i.e., bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. This amount is the net effect of these differences in the treatment of long-term debt and related items.	(196,052)
Some expenses reported in the Statement of Activities do not require the use of current financial resources (i.e., compensated absences, net pension obligation), and therefore are not accrued as expenses in governmental funds.	98,444
Internal Service funds are used by management to charge the costs of activities such as Central Garage and Machine Shop, Print Shop, Central Stores, Self Insurance, and others to individual funds. The net expense of certain activities of internal service funds is reported with governmental activities.	17,986
Change in net assets of governmental activities (page 53)	<u>\$ 150,000</u>

The accompanying notes are an integral part of the financial statements.

**PROPRIETARY FUNDS  
STATEMENT OF NET ASSETS  
JUNE 30, 2006  
( In Thousands )**

	Business-Type Activities - Enterprise Funds				
	Sewer Utility	Water Utility	Other Enterprise Funds	Total	Internal Service Funds
<b>ASSETS</b>					
Current Assets:					
Cash and Investments	\$ 177,495	\$ 154,889	\$ 89,073	\$ 421,457	\$ 106,191
Receivables:					
Accounts - Net of Allowance for Uncollectibles (Sewer \$569, Water \$732)					
Internal Service \$715	30,040	36,385	1,893	68,318	5,345
Claims - Net	-	-	-	-	17
Contributions	-	-	-	-	184
Accrued Interest	2,034	1,723	1,354	5,111	87
Grants	-	1,855	666	2,321	-
From Other Funds	-	-	3,399	3,399	-
Inventories of Water in Storage	-	26,546	-	26,546	-
Inventories	-	428	91	519	2,770
Prepaid Expenses	3	890	27	720	1,633
Total Current Assets	209,572	222,318	96,503	528,391	116,227
Non-Current Assets:					
Restricted Cash and Investments	21,079	53,240	31,814	106,133	133
Advances to Other Funds	341	844	-	985	-
Deferred Charges	6,788	4,792	-	11,580	-
Interfund Interest Receivable	-	773	-	773	-
Interfund Loan Receivable	3,487	2,388	-	5,873	-
Capital Assets - Non-Depreciable	181,206	285,466	22,519	489,191	1,984
Capital Assets - Depreciable	2,680,187	1,321,237	85,419	4,046,843	71,006
Total Non-Current Assets	2,873,088	1,668,538	119,752	4,661,378	73,123
<b>TOTAL ASSETS</b>	<b>3,082,660</b>	<b>1,890,854</b>	<b>216,255</b>	<b>5,189,769</b>	<b>189,350</b>
<b>LIABILITIES</b>					
Current Liabilities:					
Accounts Payable	11,828	32,392	2,824	46,844	16,537
Accrued Wages and Benefits	4,225	1,923	2,542	8,690	3,800
Other Accrued Liabilities	-	-	60	60	-
Interest Accrued on Long-Term Debt	6,716	11,133	20	17,869	138
Long-Term Debt Due Within One Year	52,056	17,577	3,590	73,223	40,653
Due to Other Agencies	8,263	3,937	-	12,200	-
Unearned Revenue	-	3,289	5,987	9,276	105
Contract Deposits	4,009	5,151	305	9,465	-
Current Liabilities Payable from Restricted Assets:					
Customer Deposits Payable	-	3,849	-	3,849	-
Total Current Liabilities	87,097	79,251	15,128	181,476	61,233
Non-Current Liabilities:					
Deposits/Advances from Others	-	-	30	30	-
Arbitrage Liability	17	178	-	193	-
Compensated Absences	2,973	2,359	2,958	8,290	3,715
Liability Claims	43,213	3,642	-	46,855	170,092
Capital Lease Obligations	-	-	1,006	1,006	6,040
Loans Payable	66,313	20,257	-	86,570	-
Net Revenue Bonds Payable	1,049,137	548,964	-	1,598,101	-
Estimated Landfill Closure and Postclosure Care	-	-	14,811	14,811	-
Net Pension Obligation	12,280	9,782	11,498	33,560	6,368
Total Non-Current Liabilities	1,173,933	585,180	30,303	1,789,416	186,215
<b>TOTAL LIABILITIES</b>	<b>1,261,030</b>	<b>664,431</b>	<b>45,431</b>	<b>1,970,892</b>	<b>247,448</b>
<b>NET ASSETS</b>					
Invested in Capital Assets, Net of Related Debt	1,705,452	1,075,851	85,887	2,867,190	62,415
Restricted for Debt Service	575	2,395	-	2,970	-
Restricted for Closure/Postclosure Maintenance	-	-	32,115	32,115	-
Unrestricted	115,803	148,177	52,822	316,602	(120,513)
<b>TOTAL NET ASSETS</b>	<b>\$ 1,821,830</b>	<b>\$ 1,226,423</b>	<b>\$ 170,824</b>	<b>3,218,877</b>	<b>\$ (58,098)</b>
Adjustment to reflect the consolidation of internal service fund activities related to Enterprise Funds				(7,748)	
Net assets of Business-Type activities				\$ 3,211,129	

The accompanying notes are an integral part of the financial statements.

**PROPRIETARY FUNDS**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS**  
**YEAR ENDED JUNE 30, 2006**  
(In Thousands)

	Business-Type Activities - Enterprise Funds				
	Sewer Utility	Water Utility	Other Enterprise Funds	Total	Internal Service Funds
<b>OPERATING REVENUES</b>					
Sales of Water .....	\$ -	\$ 258,900	\$ -	\$ 258,900	\$ -
Charges for Services .....	286,416	1,031	71,753	359,200	178,700
Revenue from Use of Property .....	-	4,833	-	4,833	-
Usage Fees .....	-	1,943	58,006	59,949	44,061
Other .....	4,152	13,860	4,788	22,800	2,680
<b>TOTAL OPERATING REVENUES</b> .....	<b>290,568</b>	<b>280,567</b>	<b>134,547</b>	<b>705,682</b>	<b>225,441</b>
<b>OPERATING EXPENSES</b>					
Benefit and Claim Payments .....	-	-	-	-	54,331
Maintenance and Operations .....	109,257	94,433	91,251	294,941	48,926
Cost of Materials Issued .....	-	-	322	322	25,645
Cost of Purchased Water Used .....	-	110,263	-	110,263	-
Taxes .....	-	570	-	570	-
Administration .....	90,749	35,370	37,124	163,243	58,001
Depreciation .....	64,922	29,230	9,019	103,171	21,943
<b>TOTAL OPERATING EXPENSES</b> .....	<b>264,928</b>	<b>269,866</b>	<b>137,716</b>	<b>672,510</b>	<b>208,846</b>
<b>OPERATING INCOME (LOSS)</b> .....	<b>25,640</b>	<b>10,701</b>	<b>(3,169)</b>	<b>33,172</b>	<b>16,595</b>
<b>NONOPERATING REVENUES (EXPENSES)</b>					
Earnings on Investments .....	6,578	6,966	3,310	16,854	2,744
Federal Grant Assistance .....	325	424	130	879	-
Other Agency Grant Assistance .....	136	359	535	1,030	-
Gain (Loss) on Sale/Retirement of Capital Assets .....	(443)	(9,819)	(996)	(11,258)	1,214
Debt Service Interest Expense .....	(54,132)	(23,935)	(117)	(78,184)	(504)
Other .....	4,313	(67)	2,253	6,499	413
<b>TOTAL NONOPERATING REVENUES (EXPENSES)</b> .....	<b>(43,223)</b>	<b>(26,072)</b>	<b>5,115</b>	<b>(64,180)</b>	<b>3,867</b>
<b>INCOME (LOSS) BEFORE CONTRIBUTIONS AND TRANSFERS</b> .....	<b>(17,583)</b>	<b>(15,371)</b>	<b>1,946</b>	<b>(31,008)</b>	<b>20,462</b>
Capital Contributions .....	31,976	44,262	1,364	77,602	-
Transfers from Other Funds .....	481	220	224	925	650
Transfers from Governmental Funds .....	-	-	962	962	822
Transfers to Other Funds .....	(147)	(158)	(101)	(406)	(1,169)
Transfers to Governmental Funds .....	(1,958)	(1,481)	(2,253)	(5,692)	(2,041)
<b>CHANGE IN NET ASSETS</b> .....	<b>12,769</b>	<b>27,472</b>	<b>2,142</b>	<b>42,383</b>	<b>18,724</b>
Net Assets at Beginning of Year .....	1,808,861	1,198,951	168,682		(76,822)
<b>NET ASSETS AT END OF YEAR</b> .....	<b>\$ 1,821,630</b>	<b>\$ 1,226,423</b>	<b>\$ 170,824</b>		<b>\$ (58,098)</b>
Adjustment to reflect the consolidation of internal service fund activities related to Enterprise Funds.				738	
Change in net assets of Business-Type activities				\$ 43,121	

The accompanying notes are an integral part of the financial statements.

PROPRIETARY FUNDS  
STATEMENT OF CASH FLOWS  
YEAR ENDED JUNE 30, 2006  
(In Thousands)

	Business-Type Activities - Enterprise Funds				Internal Service Funds
	Sewer Utility	Water Utility	Other Enterprise Funds	Total	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>					
Receipts from Customers and Users	\$ 294,307	\$ 283,877	\$ 114,881	\$ 693,075	\$ 203,559
Receipts from Interfund Services Provided	3,381	2,366	24,952	30,419	21,513
Payments to Suppliers	(114,057)	(145,921)	(37,728)	(297,716)	(95,276)
Payments to Employees	(54,508)	(70,518)	(80,828)	(215,955)	(103,435)
Payments for Interfund Services Used	(25,009)	(17,657)	(11,429)	(54,095)	(1,829)
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>94,105</b>	<b>51,167</b>	<b>9,466</b>	<b>154,738</b>	<b>24,456</b>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>					
Transfers from Other Funds	481	220	224	925	649
Transfers from Governmental Funds	-	-	962	962	822
Transfers to Other Funds	(147)	(158)	(101)	(406)	(1,189)
Transfers to Governmental Funds	(1,692)	(999)	(2,243)	(4,934)	(2,041)
Operating Grants Received	462	1,447	85	1,994	-
Proceeds from Advances and Deposits	-	528	-	528	-
<b>NET CASH PROVIDED BY (USED FOR) NONCAPITAL FINANCING ACTIVITIES</b>	<b>(896)</b>	<b>1,038</b>	<b>(1,073)</b>	<b>(931)</b>	<b>(1,739)</b>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>					
Proceeds from Contracts, Notes and Loans	10,093	21,525	-	31,618	-
Proceeds from Capital Contributions	18,561	16,874	1,364	36,799	-
Acquisition of Capital Assets	(41,434)	(61,747)	(3,876)	(107,057)	(9,742)
Proceeds from the Sale of Capital Assets	-	71	-	71	1,622
Principal Payments on Capital Leases	-	-	(1,470)	(1,470)	(6,222)
Principal Payments on Contracts, Notes and Loans	(3,757)	(417)	-	(4,174)	-
Principal Payments on Revenue Bonds	(27,350)	(7,968)	-	(35,358)	-
Interest Paid on Long-Term Debt	(52,762)	(23,627)	(124)	(76,523)	(5,111)
<b>NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES</b>	<b>(96,689)</b>	<b>(55,295)</b>	<b>(4,116)</b>	<b>(156,091)</b>	<b>(14,853)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>					
Sales of Investments	89,024	629,192	-	718,216	-
Purchases of Investments	(89,041)	(595,640)	-	(684,681)	-
Interest Received on Investments	6,229	6,905	2,903	16,037	2,717
<b>NET CASH PROVIDED BY INVESTING ACTIVITIES</b>	<b>6,212</b>	<b>40,457</b>	<b>2,903</b>	<b>49,572</b>	<b>2,717</b>
<b>Net Increase in Cash and Cash Equivalents</b>	<b>2,732</b>	<b>37,376</b>	<b>7,180</b>	<b>47,288</b>	<b>10,581</b>
<b>Cash and Cash Equivalents at Beginning of Year</b>	<b>174,763</b>	<b>121,362</b>	<b>113,707</b>	<b>409,832</b>	<b>95,743</b>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b>\$ 177,495</b>	<b>\$ 158,738</b>	<b>\$ 120,887</b>	<b>\$ 457,120</b>	<b>\$ 106,324</b>
<b>Reconciliation of Cash and Cash Equivalents at End of Year to the Statement of Net Assets:</b>					
Cash and Investments	\$ 177,495	\$ 154,889	\$ 89,073	\$ 421,457	\$ 105,191
Restricted Cash & Investments	21,079	53,240	31,814	106,133	133
Less Investments not meeting the definition of cash equivalents	(21,079)	(49,391)	-	(70,470)	-
<b>Total Cash and Cash Equivalents at End of Year</b>	<b>\$ 177,495</b>	<b>\$ 158,738</b>	<b>\$ 120,887</b>	<b>\$ 457,120</b>	<b>\$ 106,324</b>
<b>Reconciliation of Operating Income (Loss) to Net Cash Provided by (Used For) Operating Activities:</b>					
Operating Income (Loss)	\$ 25,640	\$ 10,701	\$ (3,169)	\$ 33,172	\$ 16,595
<b>Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided By (Used For) Operating Activities:</b>					
Depreciation	64,922	29,230	9,019	103,171	21,943
Changes in Assets and Liabilities:					
(Increase) Decrease in Receivables:					
Accounts - Net	1,280	6,588	1,743	9,611	(882)
Claims - Net	-	-	-	-	(7)
Contributions	-	-	-	-	66
From Other Funds	-	-	(235)	(235)	-
(Increase) Decrease in Inventories	-	2,427	(5)	2,422	(148)
(Increase) Decrease in Prepaid Expenses	(3)	(685)	6	(682)	(94)
Increase (Decrease) in Accounts Payable	(2,914)	2,597	(238)	(555)	4,680
Increase (Decrease) in Accrued Wages and Benefits	(2,507)	(1,912)	(2,390)	(6,809)	(2,215)
Increase (Decrease) in Liability Claims	1,470	1,520	-	2,990	(15,884)
Increase (Decrease) in Compensated Absences	(336)	(302)	(300)	(938)	(270)
Increase (Decrease) in Due to Other Agencies	283	1,557	(17)	1,823	-
Increase (Decrease) in Unearned Revenue	(4)	(329)	1,159	826	58
Increase (Decrease) in Contract Deposits	1,531	(496)	76	1,111	-
Increase (Decrease) in Arbitrage Liability	(9)	(11)	-	(20)	-
Increase (Decrease) in Net Pension Obligation	439	349	418	1,206	201
Increase (Decrease) in Estimated Landfill Closure and Postclosure Care	-	-	1,146	1,146	-
Other Nonoperating Revenue (Expenses)	4,313	(67)	2,253	6,499	413
<b>Total Adjustments</b>	<b>68,465</b>	<b>40,466</b>	<b>12,635</b>	<b>121,566</b>	<b>7,861</b>
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>\$ 94,105</b>	<b>\$ 51,167</b>	<b>\$ 9,466</b>	<b>\$ 154,738</b>	<b>\$ 24,456</b>
<b>Noncash Investing, Capital, and Financing Activities:</b>					
Developer Contributed Assets	\$ 13,415	\$ 26,351	\$ -	\$ 39,766	\$ -
Change in Fair Value of Investments	-	657	-	657	-

The accompanying notes are an integral part of the financial statements.

**FIDUCIARY FUNDS**  
**STATEMENT OF FIDUCIARY NET ASSETS**  
 June 30, 2006  
 (In Thousands)

	Pension & Employee Savings Trust	Investment Trust	Agency
<b>ASSETS</b>			
Cash or Equity in Pooled Cash and Investments .....	\$ 4,420	\$ 6,608	\$ 36,878
Cash with Custodian/Fiscal Agent .....	489,233	-	-
Investments at Fair Value:			
Short Term Investments .....	182,172	-	-
Domestic Fixed Income Securities (Bonds) .....	774,125	-	-
International Fixed Income Securities (Bonds) .....	166,743	-	-
Domestic Equity Securities (Stocks) .....	1,605,508	-	-
International Equity Securities (Stocks) .....	703,112	-	-
Mortgages .....	6	-	-
Real Estate Equity and Real Estate Securities .....	385,200	-	-
Defined Contribution Investments .....	647,021	-	-
Receivables:			
Accounts - Net .....	-	-	82
Contributions .....	31,999	-	-
Accrued Interest .....	13,119	63	20
Loans .....	26,008	-	-
Securities Sold .....	48,576	-	-
Prepaid Expenses .....	9	-	-
Securities Lending Collateral .....	581,290	-	-
Restricted Cash and Investments .....	-	-	14,273
Capital Assets - Depreciable .....	116	-	-
<b>TOTAL ASSETS</b> .....	<u>5,668,657</u>	<u>6,671</u>	<u>\$ 51,253</u>
<b>LIABILITIES</b>			
Accounts Payable .....	5,799	-	\$ -
Accrued Wages and Benefits .....	513	-	-
Due to Component Unit .....	-	-	3,578
Deposits/Advances from Others .....	-	-	18,224
Sundry Trust Liabilities .....	-	-	29,451
DROP Liability .....	225,570	-	-
Net Pension Obligation .....	239	-	-
Securities Lending Obligations .....	581,290	-	-
Securities Purchased .....	166,332	-	-
<b>TOTAL LIABILITIES</b> .....	<u>979,743</u>	<u>-</u>	<u>\$ 51,253</u>
<b>NET ASSETS</b>			
Held in Trust for Pension Benefits and Other Purposes .....	<u>\$ 4,688,914</u>	<u>\$ 6,671</u>	

The accompanying notes are an integral part of the financial statements.



FIDUCIARY FUNDS  
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS  
Year Ended June 30, 2006  
(In Thousands)

	Pension & Employee Savings Trust	Investment Trust	Total
<b>ADDITIONS</b>			
Employer Contributions .....	\$ 348,456	\$ -	\$ 348,456
Employee Contributions .....	95,003	-	95,003
Retiree Contributions .....	6,374	-	6,374
Contributions to Pooled Investments .....	-	14,411	14,411
Earnings on Investments:			
Investment Income .....	523,238	261	523,499
Investment Expense .....	(18,316)	-	(18,316)
Net Investment Income .....	504,922	261	505,183
Securities Lending Income:			
Gross Earnings .....	21,261	-	21,261
Borrow Rebates .....	(19,406)	-	(19,406)
Administrative Expenses (Lending Agent) .....	(498)	-	(498)
Net Securities Lending Income .....	1,357	-	1,357
Other Income:			
Litigation Proceeds .....	15,500	-	15,500
<b>TOTAL OPERATING ADDITIONS</b> .....	<b>971,612</b>	<b>14,672</b>	<b>986,284</b>
<b>DEDUCTIONS</b>			
DROP Interest Expense .....	17,749	-	17,749
Benefit and Claim Payments .....	306,242	-	306,242
Distributions from Pooled Investments .....	-	21,254	21,254
Administration .....	22,869	-	22,869
<b>TOTAL OPERATING DEDUCTIONS</b> .....	<b>346,860</b>	<b>21,254</b>	<b>368,114</b>
<b>CHANGE IN NET ASSETS</b> .....	<b>624,752</b>	<b>(6,582)</b>	<b>618,170</b>
Net Assets at Beginning of Year, as Restated .....	4,064,162	13,253	4,077,415
<b>NET ASSETS AT END OF YEAR</b> .....	<b>\$ 4,688,914</b>	<b>\$ 6,671</b>	<b>\$ 4,695,585</b>

The accompanying notes are an integral part of the financial statements.

**NOTES TO THE FINANCIAL STATEMENTS**  
**YEAR ENDED JUNE 30, 2006**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (In Thousands)**

The City of San Diego (the "City") adopted its current charter on April 7, 1931 and operates as a municipality in accordance with State laws. Since adoption, the City Charter has been amended several times. The most recent amendments were added by vote during the November 2004 election and took effect in January 2006. One of the amendments which took effect January 1, 2006 was the strong-mayor form of government. Under the strong-mayor form of government, the Mayor is the Chief Executive Officer of the City and has direct oversight over all City functions and services except for the City Council, Personnel, City Clerk, Independent Budget Analyst (IBA), and City Attorney's departments. Under this form of government, the Council is composed of eight members and is presided over by a Council President, who is selected by a majority vote of the Council. Residents of the City are provided with a wide range of services including parks, recreation, police, fire, water and sewer services.

The accounting policies of the City conform to accounting principles generally accepted in the United States of America ("GAAP") as applicable to governmental units. The following is a summary of the City's significant accounting policies:

**a. Financial Reporting Entity**

As required by GAAP, these financial statements present the primary government and its component units, entities for which the primary government is considered to be financially accountable.

Blended component units, although legally separate entities, are, in substance, part of the primary government's operations and as a result, data from these units are combined with data of the primary government (references within this document to "the City" are referring to the primary government). Component units should be included in the reporting entity financial statements using the blending method if either of the following criteria is met:

- i. The component unit's governing body is substantively the same as the governing body of the primary government (the City).
- ii. The component unit provides services entirely, or almost entirely, to the primary government or otherwise exclusively, or almost exclusively, benefits the primary government even though it does not provide services directly to it.

Included within the reporting entity as blended component units are the following:

- Centre City Development Corporation
- City of San Diego/Metropolitan Transit Development Board Authority
- Community Facility and Other Special Assessment Districts
- Convention Center Expansion Financing Authority
- Public Facilities Financing Authority
- Redevelopment Agency of the City of San Diego
- San Diego Data Processing Corporation
- San Diego Facilities and Equipment Leasing Corporation
- San Diego Industrial Development Authority
- San Diego Open Space Park Facilities District #1
- Southeastern Economic Development Corporation

- San Diego City Employees' Retirement System
- Tobacco Settlement Revenue Funding Corporation

A brief description of each blended component unit follows:

- Centre City Development Corporation, Inc. ("CCDC") is a not-for-profit public benefit corporation established in 1975 to administer certain redevelopment projects in downtown San Diego and to provide redevelopment advisory services to the Redevelopment Agency of the City of San Diego. CCDC's budget and governing board are approved by the City Council and services are provided exclusively to the primary government. CCDC is reported as a governmental fund. Financial statements can be requested from Centre City Development Corporation, 225 Broadway, Suite 1100, San Diego, California 92101.
- The City of San Diego/Metropolitan Transit Development Board Authority (The "MTDB Authority") is a financing authority which was established in 1988 and acquires and constructs mass transit guide ways, public transit systems, and related transportation facilities primarily benefiting the residents of the City of San Diego. The City appoints two Council members to the governing board and the MTDB Authority appoints one. The MTDB Authority primarily provides services to the primary government. The MTDB Authority is reported as a governmental fund. Financial statements can be requested from the Office of the City Auditor and Comptroller, 202 C Street, San Diego, California 92101.
- The City maintains various Community Facility, Maintenance Assessment and Business Improvement Districts to pay for the construction, maintenance and improvement of community facilities and infrastructure. The governing body of Special Assessment Districts and Community Facilities Districts (special districts) is the City's governing body. Among its duties, it approves the special districts budgets, parcel fees, special assessments, and special taxes. The special districts are reported in governmental fund types.
- The Convention Center Expansion Financing Authority (The "CCEFA") was established in 1996 to acquire and construct the expansion to the existing convention center. During the period reported, the governing board was administered by the Mayor, the City Manager, the District Director and a member of the Board of District Commissioners. The CCEFA provides services which primarily benefit the primary government. The CCEFA is reported as a governmental fund. Financial statements can be requested from the Office of the City Auditor and Comptroller, 202 C Street, San Diego, California 92101.
- The Public Facilities Financing Authority (The "PFFA") was established in 1991 and currently acquires and constructs public capital improvements. PFFA is governed by a five member board appointed by the primary government. PFFA provides services exclusively to the primary government. Financing for governmental funds is reported as a governmental activity and financing for business-type funds is reported as a business-type activity. Financial statements can be requested from the Office of the City Auditor and Comptroller, 202 C Street, San Diego, California 92101.
- The Redevelopment Agency (The "RDA") of the City of San Diego was established in 1958 in order to provide a method for revitalizing deteriorating and blighted areas of the City and began functioning in 1969 under the authority granted by the community redevelopment law. The City Council is the governing board and the RDA is reported as a governmental fund. Complete stand-alone financial statements can be requested from the Office of the City Auditor and Comptroller, 202 C Street, San Diego, California 92101.
- San Diego Data Processing Corporation ("SDDPC") was formed in 1979 as a not-for-profit public benefit corporation for the purpose of providing data processing services. SDDPC's budget and governing board are approved by the City Council. SDDPC provides services almost exclusively to the primary government. SDDPC is reported as an Internal Service Fund. Financial statements can be requested from San Diego Data Processing Corporation, 5975 Santa Fe Street, San Diego, California 92109.

- The San Diego Facilities and Equipment Leasing Corporation (The "SDFELC") is a not-for-profit public benefit corporation established in 1987 for the purpose of acquiring and leasing to the City real and personal property to be used in the municipal operations of the City. The City Council appoints two of the three members of the governing board and services are exclusively to the primary government. Financing for governmental funds is reported as a governmental activity and financing for proprietary funds is reported as a business-type activity. Financial statements can be requested from the Office of the City Auditor and Comptroller, 202 C Street, San Diego, California 92101.
- The San Diego Industrial Development Authority (The "SDIDA") was established in 1983 by the City for the purpose of providing an alternate method of financing to participating parties for economic development purposes. The City Council is the governing board. The SDIDA is reported as a governmental fund. Financial statements can be requested from the Office of the City Auditor and Comptroller, 202 C Street, San Diego, California 92101.
- The San Diego Open Space Park Facilities District #1 (The "SDOSPFD") was established in 1978 by the City for the purpose of acquiring open space properties to implement the Open Space Element of the City's General Plan. The boundaries are contiguous with those of the City. The City Council is the governing board. The SDOSPFD is reported as a governmental fund. Financial statements can be requested from the Office of the City Auditor and Comptroller, 202 C Street, San Diego, California 92101.
- Southeastern Economic Development Corporation ("SEDC") is a not-for-profit public benefit corporation organized in 1980 by the City to administer certain redevelopment projects in southeast San Diego and to provide redevelopment advisory services to the Redevelopment Agency of the City of San Diego. SEDC's governing board is appointed by the City Council and services are provided either to the City or on behalf of the City. SEDC is reported as a governmental fund. Financial statements can be requested from the Southeastern Economic Development Corporation, 995 Gateway Center Way, Suite 300, San Diego, California 92102.
- San Diego City Employees' Retirement System (SDCERS) was established in 1927 by the City and provides retirement, health insurance, disability, and death benefits. Currently, SDCERS also administers the Unified Port District and the San Diego County Regional Airport Authority defined benefit plans.

SDCERS is a legally separate, blended component unit of the City of San Diego. It is managed by a Board of Administration, the majority of which is appointed by the City of San Diego, and a Pension Administrator who does not report to, or work under the direction of the elected officials or appointed managers of the City of San Diego. SDCERS provides services almost exclusively to the primary government. Additionally, during the period reported, SDCERS utilized legal counsel independent of the City of San Diego. As such, the City does not maintain direct operational oversight of SDCERS or its financial reports.

SDCERS is reported as a pension and employee savings trust fund. Complete stand-alone financial statements can be requested from the San Diego City Employees' Retirement System, 401 West A Street, Suite 400, San Diego, California 92101.

- The Tobacco Settlement Revenue Funding Corporation (TSRFC) is a nonprofit public benefit corporation established in 2006 for the purpose of acquiring the Tobacco Settlement Revenues allocated to the City from the State of California, pursuant to the Master Settlement Agreement. TSRFC is governed by the Board of Directors which consists of two officials of the City and one independent director. The independent director shall be appointed by the Mayor or the remaining directors. TSRFC is reported as a governmental fund. Financial statements can be requested from the Office of the City Auditor and Comptroller, 202 C Street, San Diego, California, 92101.

Discretely presented component units, which are also legally separate entities, have financial data reported in a separate column from the financial data of the primary government to demonstrate they are financially and legally separate from the primary government.

There are two entities which are discretely presented component units:

- San Diego Convention Center Corporation ("SDCCC")

SDCCC is a not-for-profit public benefit corporation originally organized to market, operate and maintain the San Diego Convention Center. On July 1, 1993, SDCCC assumed similar responsibility for the San Diego Concourse. The City is a sole member of SDCCC and acts through the San Diego City Council in accordance with the City Charter and the City's Municipal Code. The City appoints seven voting members out of the nine-member Board of Directors of SDCCC. The City is liable for any operating deficits and would be secondarily liable for any debt issuances of SDCCC. SDCCC is discretely presented because it provides services directly to the citizens. Complete stand-alone financial statements can be requested from San Diego Convention Center Corporation, 111 West Harbor Drive, San Diego, California 92101.

- San Diego Housing Commission ("SDHC")

SDHC is a government agency which was formed by the City under Ordinance No. 2515 on December 5, 1978 in accordance with the Housing Authority Law of the State of California. SDHC primarily serves low-income families by providing rental assistance payments, rental housing, loans and grants to individuals and not-for-profit organizations and other services. Members of the Board of Commissioners are appointed by the Mayor and confirmed by the City Council. SDHC is discretely presented because it provides services directly to the citizens. Complete stand-alone financial statements can be requested from San Diego Housing Commission, 1122 Broadway, Suite 300, San Diego, California 92101.

Each blended and discretely presented component unit has a June 30 fiscal year-end.

b. Government-Wide and Fund Financial Statements

The government-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all of the non-fiduciary activities of the primary government and its component units. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. Likewise, the primary government is reported discretely from certain legally separate component units for which the primary government is financially accountable.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable as to a specific function or segment. Direct expenses reported include administrative and overhead charges. Program revenues include (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, the latter of which are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

c. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

**Government-wide financial statements** are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary and fiduciary funds financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

The business-type activities and proprietary funds financial statements apply all effective pronouncements of the Governmental Accounting Standards Board ("GASB"). In addition, these statements apply all Accounting Principles Board Opinions ("APBO") and Financial Accounting Standards Board ("FASB") Statements and Interpretations issued on or before November 30, 1989, except those that conflict with GASB pronouncements.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are payments-in-lieu of taxes and other charges between the government's water and sewer functions and various other functions of the government. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

All internal service funds, except for the Special Engineering Fund, have been included within governmental activities in the government-wide financial statements since they predominantly benefit governmental functions. The Special Engineering Fund, which services exclusively water and sewer activities, has been included within business-type activities in the government-wide financial statements.

Amounts reported as program revenues include (1) charges to customers for goods, services, or privileges provided, (2) operating grants and contributions, and (3) capital grants and contributions, including special assessments. General revenues include all taxes and investment income.

**Governmental funds financial statements** are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period.

Revenues which are considered susceptible to accrual include: real and personal property taxes; other local taxes; franchise fees; fines, forfeitures and penalties; motor vehicle license fees; rents and concessions; interest; and state and federal grants and subventions, provided they are received within 60 days from the end of the fiscal year.

Licenses and permits, including parking citations, charges for services, and miscellaneous revenues are recorded as revenues when received in cash because they generally are not measurable until actually received.

Expenditures are recognized when the related fund liability is incurred except for (1) principal and interest of general long-term debt which are recognized when due; and (2) employee annual leave and claims and judgments from litigation which are recorded in the period due and payable since such amounts will not currently be liquidated with expendable available financial resources.

The governmental funds financial statements do not present long-term debt, but the related debt is shown in the reconciliation of the Governmental Funds Balance Sheet to the Government-Wide Statement of Net Assets. Bond premiums, discounts and issuance costs are recognized during the current period.

**Proprietary funds** distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's proprietary funds are charges to customers for sales and services. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

**Fiduciary funds** are used to account for assets held by the City in a trustee capacity or as an agent for individuals, private organizations, and/or other governmental units, and include pension and employee savings trust, investment trust, and agency funds. Pension and Employee Savings Trust Funds are reported using the same measurement focus and basis of accounting as Proprietary Funds. Agency funds are reported using the accrual basis of accounting.

The following is the City's major governmental fund:

**General Fund** - The General Fund is the principal operating fund of the City. It is used to account for all financial resources, except those required to be accounted for in another fund.

The following are the City's major Enterprise Funds:

**Sewer Utility Fund** - The sewer utility fund is used to account for the operation, maintenance and development of the City's sewer system. The City's sewer utility fund includes activities related to the performance of services for Participating Agencies.

**Water Utility Fund** - The water utility fund is used to account for operating and maintenance costs, replacements, betterments, expansion of facilities, and payments necessary in obtaining water from the Colorado River and the State Water Project.

The following are the City's other fund types:

**Internal Service Funds** - These funds account for vehicle and transportation, printing, engineering, data processing, and storeroom services provided to City departments on a cost-reimbursement basis. Internal service funds also account for self-insurance activities, including workers' compensation and long-term disability programs, which derive revenues from rates charged to benefiting departments. This fund type also accounts for the public liability reserve, which was established for the purpose of paying liability claims.

**Pension and Employee Savings Trust Funds** - These funds account for the City Employees' Retirement System, the Supplemental Pension Savings Plan (SPSP), and the 401(k) Plan.

**Investment Trust Fund** - This fund was established to account for equity that legally separate entities have in the City Treasurer's investment pool. The Automated Regional Justice Information System (ARJIS), the San Diego Graphic Information Source (SanGIS), and the Abandoned Vehicle Abatement (AVA) are all legally separate entities which have cash invested in the City Treasurer's investment pool.

**Agency Funds** - These funds account for assets held by the City as an agent for individuals, private organizations, and other governments, including federal and state income taxes withheld from employees, parking citation revenues, and certain employee benefit plans.

d. Property Taxes

The County of San Diego (the "County") assesses, bills, and collects property taxes on behalf of numerous special districts and incorporated cities, including the City of San Diego. The City's collections of the current year's taxes are received through periodic apportionments from the County.

The County's tax calendar is from July 1 to June 30. Property taxes attach as a lien on property on January 1. Taxes are levied on July 1 and are payable in two equal installments on November 1 and February 1, and become delinquent after December 10 and April 10, respectively. Since the passage of California's Proposition 13, beginning with fiscal year ended 1979, general property taxes are based either on a flat 1% rate applied to the 1975-76 full value of the property or on 1% of the sales price of any property sold or of the cost of any new construction after the 1975-76 valuation. Taxable values of properties (exclusive of increases related to sales and new construction) can rise a maximum of 2% per year. The Proposition 13 limitation on general property taxes does not apply to taxes levied to pay the debt service on any indebtedness approved by the voters prior to June 6, 1978 (the date of passage of Proposition 13).

At the government-wide level, property tax revenue is recognized in the fiscal year for which the taxes have been levied. Property taxes received after the fiscal year in which they were levied are not considered available as a resource that can be used to finance the current year operations of the City and, therefore, are recorded as deferred revenue in the governmental funds. The City provides an allowance for uncollected property taxes of 3% of the outstanding balance which reflects historical collections.

e. Cash and Investments

The City's cash and cash equivalents for Statement of Cash Flows purposes are considered to be cash on hand, demand deposits, restricted cash, and investments held by the City Treasurer in a cash management investment pool and reported at market value. Cash equivalents reported in the Statement of Cash Flows for the Water and Sewer Utilities do not include restricted investments represented as Restricted Cash and Investments with a maturity date greater than ninety days.

The City's cash resources are combined to form a cash and investment pool managed by the City Treasurer (the pool). The pool is not registered as an investment company with the Securities and Exchange Commission (SEC) nor is it a 2a7-like pool. The investment activities of the Treasurer in managing the pool are governed by California Government Code § 53601 and the City's Investment Policy, which is reviewed by the Investment Advisory Committee and approved annually by the City Council. Interest earned on pooled investments is allocated to participating funds and entities based upon their average daily cash balance during the allocation month. Fair market value adjustments to the pool are recorded annually; however, the City Treasury reports on market values monthly. The value of the shares in the pool is equal to the fair market value of the pool.

The pool participates in the California State Treasurer's Local Agency Investment Fund (LAIF). Investments in LAIF are governed by State statutes and overseen by a five member Local Investment Advisory Board. The fair value of the City's position in LAIF may be greater or less than the value of the shares. Investments in LAIF are valued in these financial statements using a fair value factor provided by LAIF applied to the value of the City's shares in the investment pool.

It has been the City's policy to allow the General Fund to receive interest earned by certain governmental funds, internal service funds and agency funds, unless expressly stated in the resolutions creating individual funds. During the fiscal year ended June 30, 2006, approximately \$2,432 of interest was assigned from various funds to the General Fund. These transactions caused an increase to the "transfers from" amount for the General Fund and caused a like increase to the "transfer to" amount for the fund disbursing the interest. In the case of negative interest, these transactions caused an



increase to the "transfers from" amount for the fund transferring the negative interest and caused a like increase to the "transfer to" amount for the General Fund.

Certain governmental funds maintain investments outside of the City's investment pool. These funds are supervised and controlled by a five member Funds Commission which is appointed by the Mayor and confirmed by the City Council. The Funds Commission engages money managers to direct the investments of these funds. Additionally, the City and its component units maintain individual accounts pursuant to bond issuances and major construction contracts which may or may not be related to debt issuances. The investment of these funds is governed by the policies set forth in individual indenture and trustee agreements. Certain component units of the City also participate in LAIF separately from the City Treasurer's investment pool.

All City investments are reported at fair value in accordance with the GASB 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*. Note 3 of the notes to the financial statements contain additional information on permissible investments per the City investment policy and other policies applicable to the cash and investments reported herein.

The discharge of fiduciary duties by SDCERS' Board is governed by Section 144 of the City Charter and Article XVI, Section 17 of the California State Constitution. Investment decisions are made on a risk versus return basis in a total portfolio context. SDCERS' Board has the authority to delegate investment management duties to outside advisors, to seek the advice of outside investment counsel, and to provide oversight and monitoring of the investment managers it hires. Furthermore, under the California State Constitution and other relevant authorities, SDCERS' Board may, at its discretion, and when prudent in the informed opinion of the Board, invest funds in any form or type of investment, financial instrument, or financial transaction, unless otherwise limited by the San Diego City Council. SDCERS' agents, in SDCERS' name, manage all investments.

SDCERS' investments are reported at fair value in the accompanying Statement of Fiduciary Net Assets. SDCERS' custodian, State Street Bank & Trust Company, provides the market values of exchange traded assets. In the case of debt securities acquired through private placements, SDCERS' contract investment advisors compute fair value based on market yields and average maturity dates of comparable quoted securities. Short-term investments are reported at cost or amortized cost, which approximates fair value. Real estate equity investment fair values are based on either annual valuation estimates provided by SDCERS' contract real estate advisors or by independent certified appraisers. Fair value of investments in commingled funds of publicly traded securities are based on the funds' underlying asset values determined from published market prices and quotations from major investment firms.

f. Inventories

Inventories reported in the government-wide financial statements and the proprietary funds financial statements, which consist of water in storage and supplies, are valued at the lower of cost or market. Such inventories are expensed when consumed using primarily the first-in, first-out (FIFO) and weighted-average methods, respectively. Inventory supplies of governmental funds are recorded as expenditures when purchased.

g. Land Held for Resale

Land Held for Resale, purchased by the Redevelopment Agency, is reported in the government-wide and fund financial statements at the lower of cost or net realizable value. In the governmental fund financial statements, fund balances are reserved in an amount equal to the carrying value of land held for resale, with the exception of an interfund payable due to the Water Utility fund of \$1,327, because such assets are not available to finance the Redevelopment Agency's current operations.

h. Deferred Charges

In the government-wide and proprietary funds financial statements, Deferred Charges represent the unamortized portion of bond issuance costs. These costs will be amortized over the life of the related bonds using a method which approximates the effective yield method.

i. Capital Assets

Non-depreciable Capital Assets, which include land and construction-in-progress, are reported in the applicable governmental or business-type activities column in the government-wide financial statements.

Depreciable Capital Assets, which include structures and improvements, equipment, distribution and collection systems, and infrastructure, are reported in the applicable governmental or business-type activities column in the government-wide financial statements, net of accumulated depreciation. To meet the criteria for capitalization, an asset must have a useful life in excess of one year and in the case of equipment outlay, must equal or exceed a capitalization threshold of five thousand dollars. All other capital assets such as land, structures, infrastructure, and distribution and collection systems are capitalized regardless of cost. Subsequent improvements are capitalized to the extent that they extend the initial estimated useful life of the capitalized asset, or improve the efficiency or capacity of that asset. Costs for routine maintenance are expensed as incurred. Interest expenses incurred during the construction phase of business-type capital assets are reflected in the capitalized value of the asset constructed. During fiscal year 2006, \$6,437 of interest expense incurred was capitalized.

Capital assets, when purchased or constructed, are recorded at historical cost or estimated historical cost. Donated capital assets are recorded at the estimated fair market value on the date of donation. Depreciation of capital assets is computed using the straight-line method over the estimated useful life of the asset as follows:

Assets	Years
Structures and Improvements	
Buildings	40 - 50
Building Improvements	15 - 40
Equipment	
Automobiles and Light Trucks	5 - 10
Construction and Maintenance Vehicles	5 - 20
General Machinery and Office Equipment	3 - 25
Distribution and Collection Systems	
Sewer Pipes and Water Mains	15 - 150
Reservoirs	100 - 150
Infrastructure	
Pavement and Traffic Signals	12 - 50
Bridges	75
Hardscape	20 - 50
Flood Control Assets	40 - 75

j. Disposition and Development Agreement

The Redevelopment Agency and McMillin-NTC, LLC entered into a Disposition and Development Agreement, dated June 26, 2000, and a Third Implementation Agreement, dated May 6, 2003, which were executed for the purpose of effectuating the Redevelopment Plan at the Naval Training Center Redevelopment Project, in addition to constructing and installing additional infrastructure improvements as required by the City. The developer has agreed to advance the funds needed to pay for infrastructure costs. The Agency has consistently reimbursed for eligible costs as they are billed,

therefore, this agreement is not treated as a loan, and instead expenditures are recognized as payments are made to the developer and a corresponding capital asset is recorded in the government-wide financial statements.

On March 30, 2004 the Redevelopment Agency entered into a Disposition and Development Agreement with Western Pacific Housing for a condominium development project in the North Park Redevelopment Project Area. Under the agreement, the Agency promised to pay the maximum aggregate principal amount of \$3,000, of which \$2,100 represents the Affordability Component of the Agency Payment Obligation, and \$900 represents the Public Improvement Component of the Agency Payment Obligation. The Affordability Component is subject to an adjustment based on the actual project sales revenue proceeds received by the Developer. This adjustment amount cannot be computed until all 45 affordable units are sold. The principal amount outstanding bears simple interest at a rate equal to 5% per annum. Solely for the purposes of calculating the amount of interest payable, the developer shall be deemed to have paid an amount equal to 25% of the Agency's Payment Obligation as of the date which is 195 days after closing of escrow, 50% as of the date which is 390 days after closing of escrow, 75% as of the date which is 585 days after closing of escrow, and 100% at the completion date, which is the date on which the release of construction covenants under the agreement have been recorded in the official records of the San Diego County. For purposes of calculating the amount of interest payable, the principal amounts stated above will be reduced by a 10% per annum applied on a pro rata basis for the period of time the Developer is not in compliance with the schedule of performance dates stated in the agreement for commencement and completion of construction. All payments shall be made from the site-generated property tax increment. To date, only the \$900, representing the Public Improvement Component of the Agency Payment Obligation, has been recognized as a liability since the remaining \$2,100, representing the Affordability Component of the Agency Payment Obligation, is subject to adjustment upon final sales of all 45 affordable units, which has yet to occur.

k. Unearned/Deferred Revenue

In the government-wide and all fund level financial statements, unearned revenue represents revenues which have not been earned. The government-wide financial statements include revenues earned from developer credits, which are not reported in governmental funds because they are non-monetary transactions. In the governmental funds financial statements, deferred revenue represents revenues which have been earned but have not met the recognition criteria based on the modified accrual basis of accounting.

l. Interfund Transactions

The City has the following types of interfund transactions:

**Loans** – amounts provided with a requirement for repayment. Interfund loans are normally reported as interfund receivables (i.e. Due from Other Funds) in lender funds and interfund payables (i.e. Due to Other Funds) in borrower funds. The non-current portions of long-term interfund loans receivable are reported as advances. There is an interfund loan between the Capital Outlay Fund and the Water Utility Fund, for a land acquisition, which is reported as an Interfund Loan Receivable/Payable and included in Internal Balances. There is also an interfund loan between the FBA fund and the Sewer Utility fund, for developer fees owed for the Carmel Valley Trunk sewer project, which is also reported as an Interfund Loan Receivable/Payable and included in Internal Balances.

**Services provided and used** – sales and purchases of goods and services between funds for a price approximating their external exchange value. Interfund services provided and used are reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts are reported as interfund receivables and payables in the fund balance sheets or fund statements of net assets.

**Reimbursements** – repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. Reimbursement is reported as expenditures or expenses in the reimbursing fund and a reduction of expenditures or expenses in the paying fund.

**Transfers** – flows of assets (such as cash or goods) without equivalent flows of assets in return, and without a requirement for repayment. In governmental funds, transfers are reported as other financing uses in the funds making transfers and as other financing sources in the funds receiving transfers. In proprietary funds, transfers are reported after non-operating revenues and expenses.

m. Long-Term Liabilities

In the government-wide and proprietary funds financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary funds statements of net assets. Capital appreciation bond accretion, bond premiums and discounts, and bond refunding gains and losses are amortized over the life of the bonds using a method which approximates the effective yield method. Net bonds payable reflects amortized bond accretion and unamortized bond discounts, premiums and refunding gains and losses.

n. Sundry Trust Liabilities

Under approval of certain agreements, developers submit to the Redevelopment Agency an initial deposit to ensure the Developer proceeds diligently and in good faith to negotiate and perform all of the obligations under the agreement. These deposits can normally be used for administrative costs of the Redevelopment Agency. In the government-wide financial statements and in the fund financial statements, the unspent portion of these deposits, called Sundry Trust Liabilities, are reported as liabilities of the Redevelopment Agency.

o. Compensated Absences

The City provides combined annual leave to cover both vacation and sick leave. It is the City's policy to permit employees to accumulate between 8.75 weeks and 17.5 weeks of earned but unused annual leave, depending on hire date. Accumulation of these earnings will be paid to employees upon separation from service.

The liability for compensated absences reported in the government-wide, proprietary and fiduciary fund financial statements consists of unpaid, accumulated vacation and sick leave balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary level and includes salary related costs (e.g. Social Security and Medicare Tax). A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements.

p. Claims and Judgments

The costs of claims and judgments are accrued when incurred and measurable in the government-wide financial statements and both proprietary and fiduciary funds financial statements. In governmental funds, the costs of claims and judgments are recorded as expenditures when payments are due and payable.

q. Non-Monetary Transactions

The City, as part of approving new development in the community planning process, requires that certain public facilities be constructed per the provisions of community financing plans. Historically, the City has agreed to pay a pro rata share of these assets. In lieu of providing direct funding for these assets, the City often provides developers with credits (also

referred to as FBA credits) for future permit fees. These credits are earned by the developer upon successful completion of construction phases and when City engineers have accepted the work. The credits are recognized as permit revenue upon issuance and a corresponding capital asset is recorded in the government-wide financial statements.

On occasion, FBA credits may be issued in advance of receiving a completed project (capital asset). In these cases a developer must have an approved reimbursement agreement in place and provide other surety or agreement. Although performance bonds are required for all large scale projects to ensure adequate funding to complete a project, a Letter of Credit is requested to secure the credits given in advance. A Fee Deferral Agreement is required for any permits issued prior to payment of fees or issuance of credits with full payment to be made prior to final inspection. The FBA credits receivable are recognized as permit revenue upon issuance and a corresponding receivable asset is recorded in the government-wide financial statements.

r. Net Assets

In the government-wide and proprietary fund financial statements, net assets are categorized as follows:

- Invested in Capital Assets, Net of Related Debt consists of capital assets, net of accumulated depreciation, and reduced by outstanding debt attributed to the acquisition of these assets.
- Restricted Net Assets consist of assets with restrictions imposed on them by external creditors, grantors, contributors, laws and regulations of other governments, or law through constitutional provisions or enabling legislation. It is the City's policy to first apply restricted resources when an expense is incurred for purposes which both restricted and unrestricted net assets are available.
- Unrestricted Net Assets consist of net assets that do not meet the definition of Invested in Capital Assets, Net of Related Debt or Restricted Net Assets.

s. Fund Balance

In the fund financial statements, portions of fund equity of governmental funds have been reserved for specific purposes. Reservations are created to either (1) satisfy legal covenants that require a portion of the fund balance to be segregated, or (2) identify the portion of the fund balance that is not appropriable for future expenditures.

Designated fund balance indicates that portion of fund equity for which the City has made tentative plans.

Undesignated fund balance indicates that portion of fund equity which is available for appropriation in future periods.

t. Reserves

City Charter Section 91 titled "General Reserve Fund" was approved by the voters on November 6, 1962. This section requires Council to create and maintain a General Reserve Fund for the purpose of keeping the payment of running expenses of the City on a cash basis. Section 91 requires the reserve be maintained in an amount sufficient to meet all legal demands against the City Treasury for the first four months or other necessary period of each fiscal year prior to the collection of taxes. This fund may be expended only in the event of a public emergency by the affirmative vote of two-thirds of the City Council. The argument for this charter section given by the Citizens Charter Review Committee, commissioned in 1962, was to "strengthen the financial position of the City through the more efficient utilization of tax monies by reducing the amount of taxes collected and lying idle during a great part of the year, and through focusing responsibility for fiscal policies on the elected City Council."

On February 28, 1984, the City Attorney's Office issued Opinion No. 84-3 which addresses issues in regards to the City's

compliance with the funding requirements of Charter Section 91. In the opinion of the City Attorney, "To the extent that the legislative body approves the issuance of short term notes, commonly referred to as Tax or Revenue Anticipation Notes, pursuant to Section 92; or authorizes temporary loans to any tax-supported fund from any other funds in the treasury pursuant to Section 93, the General Reserve Fund required under section 91 can be reduced." Therefore, the funding requirements of Charter Section 91 have been satisfied through a combination of the General Fund reserve of \$39,884, reported within the General Fund column of the CAFR in Undesignated Fund Balance, and the provisions set forth in Charter Sections 92 and 93 for the fiscal year ended June 30, 2006.

In September 2007, the City Attorney's Office issued a new opinion that supersedes, in part, the opinion issued on February 28, 1984. The revised opinion states that the Charter Section 91 General Reserve must be a separate, legal fund. This fund, separate from the General Fund, must be funded if not at a "four month operating expenditure" level then at a level of such "other necessary funding." The City Attorney's Opinion referenced the guidance of the Government Finance Officer's Association, which recommends a level between 5% and 15% of operating expenditures as the benchmark for interpreting the required funding level that meets the intent of the City's voters. Per the City Attorney's opinion, the City will create a separate General Reserve Fund in fiscal year 2008, and the General Fund reserve monies will be transferred to that separate fund and reported therein in all future financial statements.

The City also has an internal reserve policy in relation to certain governmental long term liabilities which are repaid with Transient Occupancy Tax revenues. When the liabilities are incurred by the City, the City creates policy reserves equal to one half of the annually required lease payments in the form of a rate stabilization reserve for each liability. The purpose of the internal reserve is to make the lease payments when they are due, even if there are unanticipated fluctuations in the Transient Occupancy Tax receipts that could potentially impact the timely payment of lease payments for such liabilities. In addition to the internal rate stabilization reserve, the City may also maintain cash funded debt service reserve funds or surety guarantees with trustees in accordance with the bond indentures that exist for these liabilities. As of 06/30/06, the following is a schedule of all such rate stabilization reserves and their location in the CAFR:

<u>Rate Stabilization Reserve</u>	<u>CAFR Section</u>	<u>CAFR Column</u>	<u>Amount</u>
Convention Center Expansion	Special Revenue	Transient Occupancy Tax	\$ 6,850,531
Petco Park (PFFA-Ballpark)	Special Revenue	Transient Occupancy Tax	7,520,345
Balboa Park (SDFELC)	Special Revenue	Transient Occupancy Tax	3,286,878
Trolley (MTDB)	Special Revenue	Public Transportation	2,043,591
			<u>\$ 19,701,345</u>

u. Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities, disclosure of contingent assets and liabilities, and the related amounts of revenues and expenses. Actual results could differ from those estimates. Management believes that the estimates are reasonable.

v. Reclassification

Certain prior year amounts have been reclassified to conform to current year presentation.

## 2. RECONCILIATION OF GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS (In Thousands)

Certain adjustments are necessary to reconcile governmental funds to governmental activities (which includes all internal service funds except the Special Engineering Fund). The reconciliation of these adjustments are as follows:

- a. Explanation of certain differences between the Governmental Funds Balance Sheet and the Government-wide Statement of Net Assets:

The Governmental Funds Balance Sheet includes a reconciliation between Total Fund Balances-Governmental Funds and Total Net Assets-Governmental Activities as reported in the Government-wide Statement of Net Assets. One element of the reconciliation states, "Other assets and liabilities used in governmental activities are not financial resources (uses), and therefore, are either deferred or not reported in the funds." The details of this \$135,085 difference are as follows:

Deferred Charges, net, July 1, 2005	\$ 20,869
Issuance Costs	4,815
Amortization Expense	(1,099)
Deferred Charges, net, June 30, 2006	<u>24,585</u>
Deferred Revenue:	
Taxes Receivable	12,340
Sales Taxes Receivable	5,837
Motor Vehicle License Receivable	709
Special Assessments Receivable	1,174
Notes Receivable	12,701
Grants and Other Receivables	<u>65,952</u>
Deferred Revenue, net, June 30, 2006	<u>98,713</u>
FBA Credit Receivable	13,267
Padre Land Acquisition Credit Payable	<u>(1,480)</u>
Net Adjustment to increase Total Fund Balances - Governmental Funds to arrive at Total Net Assets of Governmental Activities	<u>\$ 135,085</u>

Another element of the reconciliation states, "Certain liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds." The details of this (\$1,675,325) difference are as follows:

Interest Accrued on Long-Term Debt	\$ (21,628)
Compensated Absences	(65,345)
Capital Leases Payable	(29,966)
Contracts Payable	(2,615)
Notes Payable	(7,294)
Loans Payable	(14,345)
Section 108 Loans Payable	(42,499)
SANDAG Loans Payable	(7,355)
Net Bonds Payable	<u>(1,320,506)</u>
Accretion of Interest on Capital Appreciation Bonds	(9,219)
Net Pension Obligation	<u>(154,553)</u>
Net adjustment to decrease Total Fund Balances - Governmental Funds to arrive at Total Net Assets - Governmental Activities	<u>\$ (1,675,325)</u>

- b. Explanation of certain differences between the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances and the Government-wide Statement of Activities:

The Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances includes a reconciliation between "Net Change in Fund Balances-Total Governmental Funds" and "Changes in Net Assets of Governmental Activities" as reported in the Government-wide Statement of Activities. One element of that reconciliation explains, "Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense." The details of this \$40,817 difference are as follows:

Capital Projects	\$ 126,583
Other Capital Activities	31,235
Depreciation Expense	<u>(117,001)</u>
Net Adjustment to increase Net Changes in Fund Balances -	
Total Governmental Funds to arrive at Changes in Net	
Assets of Governmental Activities	<u>\$ 40,817</u>

Another element of the reconciliation states "The net effect of various miscellaneous transactions involving capital assets (i.e., donations, retirements, and transfers) is to decrease net assets." The details of this (\$5,135) are as follows:

In the Statement of Activities, only the loss on the sale of capital assets is reported. However, in the governmental funds, the proceeds from the sale increase financial resources. Thus, the change in net assets differs from the change in fund balances by the cost of the capital assets sold.

\$ (1,615)

Donations and transfers of capital assets increase net assets in the Statement of Activities, but do not appear in the governmental funds because they are not financial resources.

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The Statement of Activities reports losses arising from the retirement of existing capital assets. Conversely, governmental funds do not report any gain or loss on retirements of capital assets.

(4,278)

Net adjustment to decrease Net Change in Fund Balances - Total Governmental Funds to arrive at Changes in Net Assets of Governmental Activities

\$ (5,135)



Another element of the reconciliation states "The issuance of long-term debt (i.e., bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets." The details of this (\$196,052) difference are as follows:

## Debt Issued or Incurred:

Capital Leases	\$ (20,087)
Contracts Payable	(900)
Loans Payable	(9,171)
Section 108 Loans	(2,151)
SANDAG Loans	(1,651)
Tax Allocation Bonds	(109,985)
Tobacco Settlement Asset-Backed Bonds	(105,400)

## Principal Repayments:

Capital Leases	3,972
Notes Payable	630
Loans Payable	13
Section 108 Loans	2,510
SANDAG Loans	8,275
G.O. Bonds	1,840
Revenue Bonds	21,435
Special Assessment Bonds/Special Tax Bonds	3,700
Tax Allocation Bonds	<u>10,918</u>

## Net adjustment to decrease Net Changes in Fund Balances -

Total Governmental Funds to arrive at Changes in Net Assets of Governmental Activities	\$ <u>(196,052)</u>
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Another element of the reconciliation states that "Some expenses reported in the Statement of Activities do not require the use of current financial resources (i.e., compensated absences, net pension obligation) and therefore are not accrued as expenses in governmental funds." The details of this \$98,444 difference are as follows:

Compensated Absences	\$ 2,498
Net Pension Obligation	96,515
Accrued Interest	(24)
Current Year Premiums/Discounts and Interest Accretion	
Less Amortization of Bond Premiums	(4,261)
Issuance Costs Less Current Year Amortization	<u>3,716</u>

## Net adjustment to increase Net Changes in Fund Balances -

Total Governmental Funds to arrive at Changes in Net Assets of Governmental Activities	\$ <u>98,444</u>
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### 3. CASH AND INVESTMENTS (In Thousands)

The following is a summary of the carrying amount of cash and investments:

	Governmental Activities	Business-Type Activities	Fiduciary Statement of Net Assets other than SDCERS	Subtotal	SDCERS Fiduciary Statement of Net Assets	Grand Total
Cash & Cash or Equity in Pooled Cash & Investments	\$ 891,550	\$ 461,797	\$ 58,219	\$ 1,411,566	\$ 3,960	\$ 1,415,526
Cash & Investments with Fiscal Agent	132,413	70,470	-	202,883	489,233	692,116
Investments at Fair Value	159,840	-	647,021	806,861	3,826,866	4,633,727
Securities Lending Collateral	-	-	-	-	581,290	581,290
<b>TOTAL</b>	<b>\$ 1,183,803</b>	<b>\$ 532,267</b>	<b>\$ 705,240</b>	<b>\$ 2,421,310</b>	<b>\$ 4,901,349</b>	<b>\$ 7,322,659</b>

#### a. Cash & Cash or Equity in Pooled Cash & Investments

Cash & Cash or Equity in Pooled Cash & Investments represents petty cash, cash at the bank in demand deposit and/or savings accounts, and cash in escrow for contract retention payables. Furthermore, it represents equity in pooled cash and investments, which is discussed in further detail below.

As provided for by California Government Code, the cash balance of substantially all funds and certain outside entities are pooled and invested by the City Treasurer for the purpose of increasing interest earnings through investment activities. The respective funds' shares of the total pooled cash and investments are included in the table above under the caption Cash & Cash or Equity in Pooled Cash & Investments.

The following represents a summary of the items included in the Cash & Cash or Equity in Pooled Cash & Investments line item:

Cash on Hand	\$ 206
Cash Deposits	2,607
Deposits Held in Escrow Accounts	14,273
Pooled Investments in the City Treasury	1,398,440
<b>Total Cash &amp; Cash or Equity in Pooled Cash &amp; Investments</b>	<b>\$ 1,415,526</b>

A summary of the investments held by the City Treasurer's investment pool as of June 30, 2006 is as follows:

Investment	Fair Value	Cost	Coupon Rate % Range	Maturity Range
US Treasury Bills	\$ 24,642	\$ 24,489	4.705-4.785 *	10/12/06-10/19/06
US Treasury Notes & Bonds	333,354	338,083	2.625-4.75	05/15/07-02/15/10
US Agency Discount Notes	298,682	296,049	4.42-5.29 *	08/02/06-04/27/07
US Agency Notes & Bonds	523,968	529,833	2.25-6.00	08/15/06-05/15/11
Bank Notes	4,950	4,957	2.50	11/01/06
Certificate of Deposit	9,832	9,897	3.87	06/07/07
Commercial Paper	99,491	99,309	4.80-5.40 *	07/03/06-10/25/06
Corporate Notes	70,040	71,376	2.80-6.875	11/01/06-03/04/08
Local Agency Investment Fund	21,765	21,805	4.03 **	N/A
Repurchase Agreement	11,716	11,716	5.19	07/03/06
	<u>\$ 1,398,440</u>	<u>\$ 1,407,514</u>		

\* Discount Rates

\*\* LAIF - Fair Value is adjusted to account for LAIF factor

The following represents a condensed statement of net assets and changes in net assets for the City Treasurer's investment pool as of June 30, 2006:

Statement of Net Assets

Investments of Pool Participants	\$ 1,398,440
Accrued Interest Receivable of Internal Pool Participants	12,708
Accrued Interest Receivable of External Pool Participants	63
Total Investments and Interest Receivable	<u>1,411,211</u>
Equity of Internal Pool Participants	\$ 1,404,540
Equity of External Pool Participants (SanGIS, ARJIS & AVA) **	6,671
Total Equity	<u>\$ 1,411,211</u>

\*\*Voluntary Participation

Statement of Changes in Net Assets

Net Assets Held for Pool Participants at July 1, 2005	\$ 1,293,195
Net Change in Investments by Pool Participants	105,245
Accrued Interest Receivable at June 30, 2006	12,771
Total Net Assets Held for Pool Participants at June 30, 2006	<u>\$ 1,411,211</u>

b. Cash & Investments with Fiscal Agents

Cash & Investments with Fiscal Agents represents cash and investments held by fiscal agents resulting from bond issuances. More specifically, these funds represent reserves held by fiscal agents or trustees as legally required by bond issuances and liquid investments held by fiscal agents or trustees which are used to pay debt service. The San Diego City Employees' Retirement System (SDCERS) portion of Cash & Investments with Fiscal Agents represents funds held as cash collateral from market neutral portfolios (domestic fixed income investment strategy). Furthermore, it represents transaction settlements, held in each investment manager's portfolio, which is invested overnight by SDCERS' custodial bank.

c. Investments at Fair Value

Investments at Fair Value represents investments of the City's Supplemental Pension Savings Plan, 401(k) Plan, San Diego City Employees' Retirement System (SDCERS), investments managed by the City Treasurer (which are not part of the pool), and investments managed by the Funds Commission (e.g. Cemetery Perpetuity, Effie Sergeant, Gladys Edna Peters, Los Penasquitos Canyon, and the Edwin A. Benjamin Library Fund).

d. Securities Lending Collateral (SDCERS Only)

SDCERS has agreed with a fiscal agent, currently its custodial bank State Street Bank & Trust Company, to lend domestic and international equity and domestic and international fixed income securities to broker-dealers and banks in exchange for pledged collateral. A simultaneous agreement is entered into by which the fiscal agent agrees to return the collateral plus a fee to the borrower in the future for return of the same securities originally lent. All securities loans can be terminated on demand by either the lender or the borrower.

The fiscal agent managed the securities lending program and received cash (United States and foreign currency), securities issued or guaranteed by the United States government, sovereign debt rated "A" or better, Canadian provincial debt, convertible bonds, and irrevocable letters of credit as collateral. State Street did not have the ability to pledge or sell collateral securities delivered absent a borrower default. Borrowers were required to deliver collateral for each loan equal to: (i) in the case of loaned securities denominated in United States dollars or whose primary trading market was located in the United States or sovereign debt issued by foreign governments, 101.5% of the market value of the loaned securities; and (ii) in the case of loaned securities not denominated in United States dollars or whose primary trading market was not located in the United States, 104.5% of the market value of the loaned securities.

SDCERS had limited credit risk exposure to borrowers because the amounts provided to the fiscal agent on behalf of SDCERS, in the form of collateral plus accrued interest, exceeded the amounts broker-dealers and banks owed to the fiscal agent on behalf of SDCERS for securities borrowed. State Street has indemnified SDCERS by agreeing to purchase replacement securities or return cash collateral in the event a borrower fails to return or pay distributions on a loaned security. Non-cash collateral (securities and letters of credit) cannot be pledged or sold without a borrower default and are therefore not reported as an asset of SDCERS for financial reporting purposes.

The SDCERS securities lending transactions collateralized by cash as of June 30, 2006 had a fair value of \$569,928 and a collateral value of \$581,290, which were reported in the assets and liabilities in the statements of plan net assets for the City Employees' Retirement System in accordance with GASB Statement No. 28. The securities lending transactions collateralized by securities, irrevocable letters of credit, or tri-party collateral had a fair value of \$8,700 and a collateral value of \$9,073, which were not reported in the assets or liabilities in the accompanying statements of plan net assets for the City Employees' Retirement System per GASB Statement No. 28. The total collateral pledged to SDCERS at fiscal year end for its securities lending activities was \$590,363.

The cash collateral received on lent securities was invested by State Street, together with the cash collateral of other qualified tax-exempt plan lenders, in a collective investment pool. Because the securities loans were terminable at will, their duration did not generally match the duration of the investments made with cash collateral. As of June 30, 2006, the investment pool had an average duration of 49 days and an average weighted maturity of 450 days.

SDCERS may encounter various risks related to securities lending agreements. However, the fiscal agent is required to maintain its securities lending program in compliance with applicable laws of the United States and all countries in which lending activities take place, and all rules, regulations, and exemptions from time to time promulgated and issued under the authority of those laws.

e. Investment Policy**City Treasurer's Investment Policy**

In accordance with the Charter §45 of the City of San Diego and under authority annually approved by the City Council, the City Treasurer is responsible for the safekeeping and investment of the unexpended cash in the City Treasury according to the City's Investment Policy (the "Policy"). This Policy applies to all of the investment activities of the City except for the pension trust funds, the proceeds of certain debt issues which are managed and invested at the direction of the City Treasurer in accordance with the applicable indenture or by Trustees appointed under indenture agreements or by fiscal agents, and the assets of trust funds which are placed in the custody of the Funds Commission by Council ordinance.

The Policy is reviewed annually by the Investment Advisory Committee (IAC) which makes recommendations regarding the Policy to the City Treasurer. The IAC consists of two City representatives and three outside financial professionals with market and portfolio expertise not working for the City of San Diego. The City Council reviews the Policy and considers approval on an annual basis.

The IAC evaluates the horizon returns, risk parameters, security selection, and market assumptions the City's investment staff is using when explaining the City's investment returns. The IAC also meets semi-annually to review the previous two quarters' investment returns and make recommendations to the City Treasurer on proposals presented to the IAC by the Treasurer's staff.

The Policy is governed by the California Government Code (CGC), Sections 53600 et seq. The following table presents the authorized investments, requirements, and restrictions per the CGC and the City Policy:

Investment Type	Maximum Maturity (1)		Maximum % of Portfolio		Maximum % with One Issuer		Minimum Rating	
	CGC	City Policy	CGC	City Policy	CGC	City Policy	CGC	City Policy
US Treasury Obligations (bills, bonds, or notes)	5 years	5 years	None	None	None	None	None	None
US Agencies	5 years	5 years	None	(2)	None	(2)	None	None
Bankers' Acceptances (6)	180 days	180 days	40%	40%	30%	10%	None	(3)
Commercial Paper (6)	270 days	270 days	25%	25%	10%	10%	P1	P1
Negotiable Certificates (6)	5 years	5 years	30%	30%	None	10%	None	(3)
Repurchase Agreements	1 year	1 year	None	None	None	None	None	None
Reverse Repurchase Agreements (4)	92 days	92 days	20%	20%	None	None	None	None
Local Agency Investment Fund	N/A	N/A	None	None	None	None	None	None
Non-Negotiable Time Deposits (6)	5 years	5 years	None	25%	None	10%	None	(3)
Medium Term Notes/Bonds (6)	5 years	5 years	30%	30%	None	10%	A	A
Mutual Funds	N/A	N/A	20%	5%	10%	None	AAA	AAA
Notes, Bonds, or Other Obligations	5 years	5 years	None	None	None	None	None	AA
Mortgage Pass-Through Securities	5 years	5 years	20%	None	None	20%	AA	AAA
Financial Futures (5)	N/A	None	None	None	None	None	None	None

## Footnotes:

- (1) In the absence of a specified maximum, the maximum is 5 years.
- (2) The Prudent Investor Rule applies.
- (3) Credit and maturity criteria must be in accordance per Section X of the City's Investment Policy.
- (4) Maximum % of portfolio for Reverse Repurchase Agreements is 20% of base value.
- (5) Financial futures transactions would be purchased only to hedge against changes in market conditions for the reinvestment of bond proceeds.
- (6) Investment types with a 10% maximum with one issuer are further restricted per the City's Investment Policy: 5% per issuer and an additional 5% with authorization by City Treasurer.

According to the Policy, the City may enter into repurchase and reverse repurchase agreements only with primary dealers of the Federal Reserve Bank of New York with which the City has entered into a master repurchase agreement. Exceptions to this rule can be made only upon written authorization of the City Treasurer.

Additionally, the Policy authorizes investment in other specific types of securities. The City may invest in floating rate notes with coupon resets based upon a single fixed income index (which would be representative of an eligible investment), provided that security is not leveraged. Structured notes issued by U.S. government agencies that contain imbedded calls or options are authorized as long as those securities are not inverse floaters, range notes, or interest only strips derived from a pool of mortgages. A maximum of 8% of the "base value" of the pooled portfolio may be invested in structured notes.

The types of investments listed below are additionally restricted as to percentage of the cost value of the portfolio in any one issuer name up to a maximum of 5%. The total cost value invested in any one issuer name will not exceed 5% of an issuer's net worth. An additional 5% or a total of 10%, of the cost value of the portfolio in any one issuer name can be authorized upon written approval of the City Treasurer.

- Bankers' Acceptances
- Commercial Paper
- Medium Term Corporate Notes/Bonds
- Negotiable and Non-negotiable Certificates of Deposit

Ineligible investments include, but are not limited to, common stocks and long-term corporate notes/bonds, are prohibited from use in the portfolio. A copy of the investment Policy can be requested from the City Treasurer, 1200 3rd Avenue, Suite 1624, San Diego, CA 92101.

#### **San Diego City Employees' Retirement System Investment Policy**

Investments for the pension trust fund are authorized to be made by the Board of Administration of the SDCERS (Board) in accordance with Section 144 of the City Charter and the California State Constitution Article XVI, Section 17. The Board is authorized to invest in any securities that are allowed by general law for savings banks. The Board can also invest in additional investments as approved by resolution of the San Diego City Council. These investments include, but are not limited to, bonds, notes and other obligations, real estate investments, common stock, preferred stock, and pooled vehicles. Additionally, investment policies permit the pension trust fund to invest in financial futures contracts provided the contracts do not leverage SDCERS' Trust Fund portfolio. Financial futures contracts, which are recorded at fair value each day, are not hedges of existing assets, and changes in the fair value of the contract result in recognition of a gain or loss. Investment earnings from the pension trust fund are accounted for in accordance with GASB 25.

A copy of the SDCERS investment policy and additional details on the results of the system's investment activities are available at 401 West A Street, Suite 400, San Diego, CA 92101.

### Other Investment Policies

The City currently has a Funds Commission whose role is to supervise and control all trust, perpetuity, and investment funds of the City and such pension funds as shall be placed in its custody. The statutory authority for the Funds Commission is created in the City Charter Article V, section 41(a). While the duties described in the creation document form broad authority for the Funds Commission, in practice, the Funds Commission only oversees investments related to a small number of permanent endowments. The allowable investments for these funds are different than those as prescribed in the City Treasurer's investment policy. Each permanent endowment fund has its own separate investment policy. Copies of the individual investment policies can be requested from the City Treasurer, 1200 3rd Avenue, Suite 1624, San Diego, CA 92101. Additionally, the City and its component units have funds invested in accordance with various bond indenture and trustee agreements.

f. Interest Rate Risk – City of San Diego (excluding San Diego City Employees' Retirement System)

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Market or interest-rate risk is intended to be mitigated by establishing two portfolios with target durations based upon the expected short and long-term cash needs of the City. The liquidity portfolio is structured with an adequate mix of highly liquid securities and maturities to meet major cash outflow requirements for at least six months (per CGC Section 53646). The liquidity portfolio uses the Merrill Lynch 3-6 month Treasury Index as a benchmark with a duration of plus or minus 40% of the duration of that benchmark. The core portfolio uses the Merrill Lynch 1-3 year Treasury Index as a benchmark with a duration of plus or minus 20% of the duration of that benchmark. It consists of high quality liquid securities with a maximum maturity of 5 years and is structured to meet the longer-term cash needs of the City. Information about the sensitivity of the fair value of the City's investments to market interest rate fluctuations is presented in the table on the next page.